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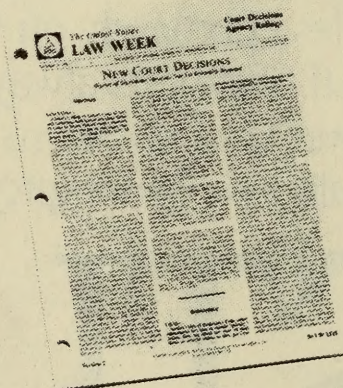
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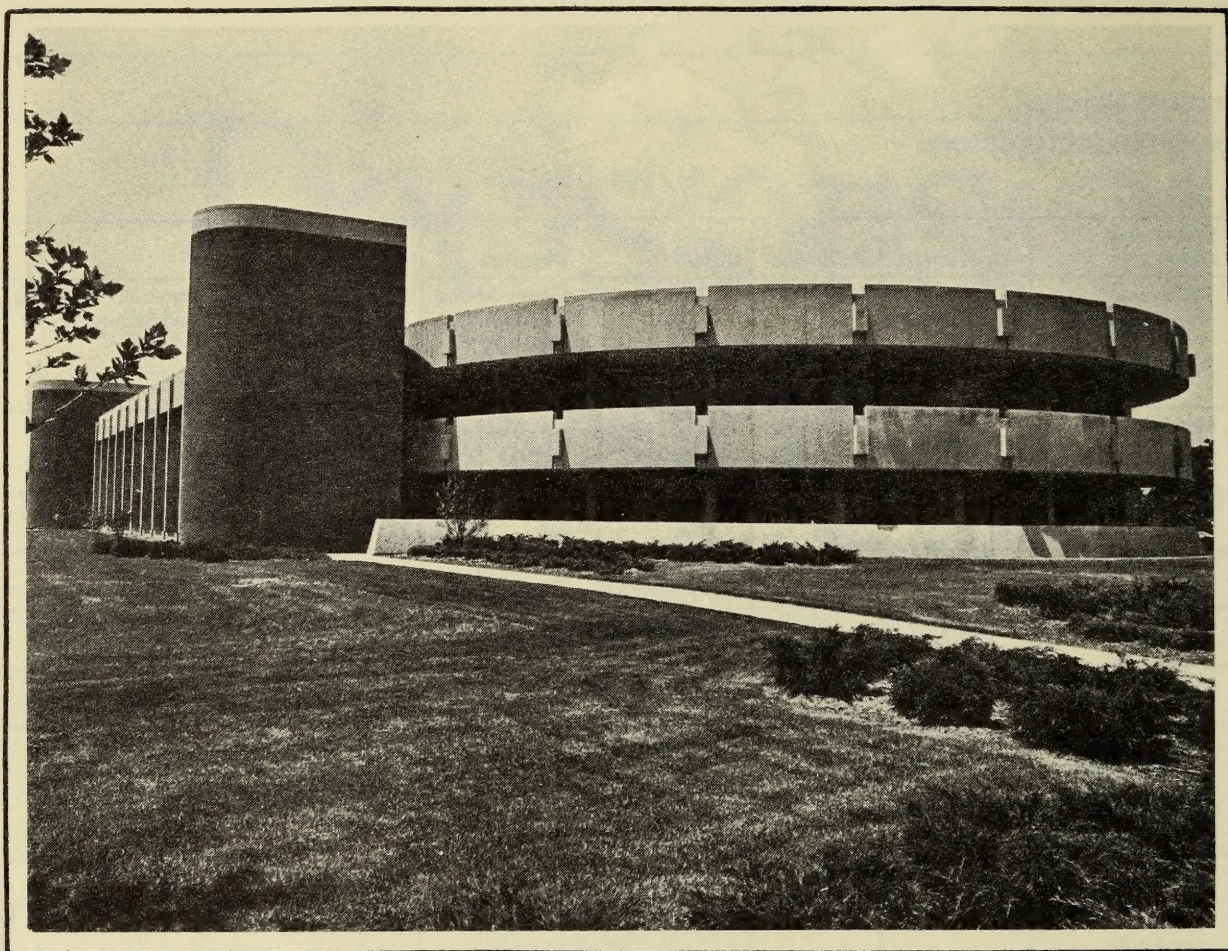
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## **Dedication**

G. Kent Frandsen

1927-1988

Associate Dean for Student Affairs  
and

Associate Professor of Law  
Indiana University School of Law—Indianapolis

G. Kent Frandsen, Associate Dean for Student Affairs and Associate Professor of Law at Indiana University School of Law—Indianapolis, died November 16, 1988, at his home in Lebanon. The sudden illness that took his life felled a central figure in the modern history of the legal profession in this state.

In 1965, Kent began his career as legal educator and law school administrator by accepting an appointment as Assistant to the Dean and Associate Professor of Law at the Indiana University School of Law—Indianapolis Division. Over the twenty-three years of his service in those capacities, his commitment to the mission of the School of Law remained total and steadfast. That commitment involved him in a great variety of tasks but all of his efforts were informed by his primary duty to serve students. Known by thousands of students over the years simply as “The Dean,” he directed recruitment, admissions, registration, financial aid, counselling, and placement. For a brief stint, he served as Acting Dean of the School of Law to ease the transition between two of the seven Deans he served. He especially enjoyed his function as Marshal at the annual Commencement exercises and took great pride in leading the procession of faculty and students at the School of Law Hooding Ceremony. Each year at these proceedings, as Kent read the roll of graduates, he bestowed on one surprised student the new middle name of “Cardozo,” as much a public tribute to the student as to the great judge of that name.

Kent taught courses in Insurance Law and Professional Responsibility and his students were quick to recognize his classroom talents. In 1969, they awarded him the student prize for outstanding teaching, the “Black Cane,” the first time that award was conferred. He took great interest in students as individuals and his door was always open to them. Although the entrants sometimes knew they might not like the Dean’s advice, they could always be confident that it was honest, unequivocal, and from the heart. His student showed their affection for him by renaming the annual School of Law golf tournament in his honor. He returned their affection in many ways—from witnessing their swearing-in ceremonies to helping them out of his own pocket, from conferring sometimes blustery advice to bragging about their bar exam performances.

His reputation as a stalwart of the School of Law rests upon his unswerving, uncomplicated, passionate, humane desire to help his charges



realize their ambitions. The fires of his life burned brightest when the odds against success for the student were highest. Many are the tributes from successful attorneys around the state who acknowledge that Dean Frandsen was instrumental in creating or preserving opportunities for them when they thought their cause was lost. The high regard his professional colleagues and former students held for him was evidenced in 1983 when he was honored as the Law School's Distinguished Alumnus. In 1984, the graduating class honored him by creating a permanent scholarship fund in his name. That fund will stand as a prominent and lasting tribute to Kent and to the work he most enjoyed.

He served the School of Law in many other capacities as well. He was the representative for the School on the Law School Admissions Council and was a member of the Indianapolis Bar Association Committee on Liaison with Law Schools. He has even been seen on several occasions sorting the mail for the Law Faculty on days when the staff were observing a University holiday. In many other ways, Kent quietly and without notice served his fellow human beings.

Kent Frandsen's service to the University, the state, and the profession extended well beyond the walls of the School of Law. He annually served on University student recruitment and retention committees, financial aid, scholarship, and fellowship committees, and the Student Advisory Council. He participated as author and lecturer in many continuing legal education seminars, often banging away at a typewriter in his two-fingered style, after hours, doing the notes and manuscripts. In 1970, he was appointed by the Governor to the Indiana Criminal Law Study Commission, where he chaired the subsection on Organized Crime which formulated three proposals enacted into law by the General Assembly in 1980. He also chaired the Medical and Legal Committee of the Marion County Medical Society and the Indianapolis Bar Association. In 1969, while on leave from the University, he served as Chief Staff Counsel in the office of the Indiana Attorney General. From 1970 to 1980, he served as a City Judge in Lebanon in his spare time.

His life marked the dimensions of a happy chapter in the development of the School of Law which spanned three decades. His death marks the passage of what must be known, when the history of the School of Law is written, as The Frandsen Era.

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# Indiana Law Review

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## *McClanahan v. Remington Freight Lines, Inc.*: Making a Mountain Out of a Molehill

RICHARD PITTS\*

Susan Stuart\*\*

### I. INTRODUCTION

In 1987, the Indiana Supreme Court confronted head-on the issue of whether administrative agency decisions could be given *res judicata* or collateral estoppel effect in subsequent proceedings in *McClanahan v. Remington Freight Lines, Inc.*<sup>1</sup> This Article addresses the historical precedents for application of the two doctrines in administrative law, discusses the impact of the supreme court's decision in *McClanahan*, and reviews the issues likely to arise in future, similar instances.

The doctrine of *res judicata* stems from the basic principle that a matter which has been litigated and determined should not be re-litigated. Litigation must be final.<sup>2</sup> *Res judicata* itself is also known as claim preclusion. Claim preclusion means that a previous adjudication of an action is a total bar to the same action in a subsequent suit.<sup>3</sup> A derivative of *res judicata* is collateral estoppel, also known as issue preclusion. Issue preclusion generally does not work to bar a claim *in toto*, though it may as a practical matter have that effect. Rather, issue preclusion functions only to prevent a party from re-litigating a particular factually-

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\* Associate, Lowe, Gray, Steele and Hoffman, Indianapolis. Former Law Clerk to the Honorable Patrick D. Sullivan, Indiana Court of Appeals. A.B., Wabash College, 1983; J.D. Indiana University School of Law—Indianapolis, 1986.

\*\* Associate, Lowe, Gray, Steele and Hoffman, Indianapolis. Former Law Clerk to the Honorable Stanley B. Miller and the Honorable Patrick D. Sullivan, Indiana Court of Appeals. B.A., Depauw University, 1973; M.Ed., Valparaiso University, 1976; J.D., Indiana University School of Law—Indianapolis, 1982.

1. 517 N.E.2d 390 (Ind. 1988).

2. See *State v. Gurecki*, 247 Ind. 218, 214 N.E.2d 392 (1966); *Barker v. State*, 244 Ind. 267, 191 N.E.2d 9 (1963).

3. *Hardesty v. Bolerjack*, 441 N.E.2d 243, 245 (Ind. Ct. App. 1982).



oriented issue in a subsequent action, even if the causes of action in the two cases differ.<sup>4</sup>

The basic requirements for *res judicata* are: (1) a court of competent jurisdiction, (2) a final judgment on the merits, (3) between the same parties or their privies, (4) on all matters essential to that judgment which were or might have been litigated.<sup>5</sup> The basic requirements for collateral estoppel are (1) the same parties, (2) actually litigated the point subsequently at issue, and (3) both would have been bound by the determination had it been adverse to them.<sup>6</sup>

## II. HISTORICAL PRECEDENT

### A. *Indiana Law*

Perhaps unwittingly, Indiana courts began sanctioning the use of *res judicata* to give preclusive effect to an agency decision nearly one hundred years ago. In *Bass Foundry & Machine Works v. Board of Commissioners*,<sup>7</sup> a contractor abandoned the county's project to build a courthouse and jail. Bass Foundry, a subcontractor, agreed with the county to complete its iron work on the project at the original contract price, notwithstanding the fact that iron prices had doubled in the interim. In return, the county agreed to pay Bass Foundry all amounts due and owing under the original contract despite a previous court determination which held that the county did not have the authority to agree to pay the full contract price.<sup>8</sup> Bass Foundry then filed its claim with the county commissioners, who subsequently denied payment. No appeal of the commissioners' decision was taken. Instead, an independent action was instituted.

The county alleged the previous resolution of the issue (denial by the county commissioners) was a bar to Bass Foundry's subsequent suit. The Indiana Supreme Court agreed, citing an 1879 statute which deprived circuit courts of jurisdiction in cases involving County Commissioners, except when an appeal was taken from the County Commissioners' decision. Had the case been left to that statutory, jurisdictional point alone, there would have been little to commend it as a case giving *res judicata* effect to an administrative decision. The supreme court went beyond the statutory basis, however, and noted: "The purpose of filing

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4. *Id.*

5. See *Coulson v. State*, 488 N.E.2d 1154 (Ind. Ct. App. 1986); *In re Marriage of Moser*, 469 N.E.2d 762 (Ind. Ct. App. 1984).

6. *Hardesty*, 441 N.E.2d at 245.

7. 141 Ind. 68, 32 N.E. 1125 (1894).

8. *Bass Foundry & Machine Works v. Bd. of Comm'rs*, 115 Ind. 234, 17 N.E. 593 (1888).



the claim before the board of commissioners was to recover the claim from the county, and that is the purpose and object of this suit, and the question is *res judicata* . . . .”<sup>9</sup>

The *Bass Foundry* analysis cleaves remarkably close to the analysis given to the issue today. The supreme court noted that the identity of the issues was the same in the court case and the administrative litigation: recovery of sums allegedly due under the second contract. Identity of issues is, of course, a keystone to modern *res judicata* decisions. The *Bass Foundry* court went further and noted that the identity of the parties was also the same: the county was, as the court termed it, a “real party in interest.”<sup>10</sup> The court reasoned that addition of the original defaulting contractor as a party could not defeat this congruity of identities.<sup>11</sup> Again, the *Bass Foundry* court, having little or no difficulty according the Commissioner’s determination the same weight it would give to a previous trial court ruling, seized upon the fact that the parties were the same in both adjudications to validate the *res judicata* defense. Modern *res judicata* theory tends to demand this as well prior to successful invocation of the defense.<sup>12</sup>

*Bass Foundry* did not launch a full-scale application of *res judicata* to administrative decisions. Courts began to struggle with the issue—not in terms of the *res judicata* doctrine itself, but in terms of whether an administrative decision was attended by the qualities and characteristics which should give rise to *res judicata*. In short, was the administrative decisional process sufficiently court-like to permit the administrative decisions to become final?

The supreme court itself suggested that the answer was no in *Board of Commissioners, Allen County v. Trautman*.<sup>13</sup> When Helen Trautman thought she had been underpaid as a clerk in the county assessor’s office, she filed a claim with the county board of commissioners. The board of commissioners disallowed the claim for the excess pay but did regularly pay the semi-monthly claims on the amounts agreed to be due. Trautman sued for the excess and received judgment in her favor. The Indiana Supreme Court affirmed the judgment, brushing away the county’s contention that the commissioners’ decision on the claim was *res judicata*. The court cited a statute authorizing a claimant either to seek judicial review or sue independently but did not distinguish between judicial review of an administrative decision and a collateral attack. Instead, the court simply stated that the commissioners’ decision was

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9. *Bass Foundry*, 141 Ind. at 72, 32 N.E. at 1126 (emphasis in original).

10. *Id.*

11. *Id.*

12. See *supra* notes 4-6 and accompanying text.

13. 204 Ind. 362, 184 N.E. 178 (1933).



“administrative or ministerial and not judicial.”<sup>14</sup> Presumably, therefore, the commissioners’ decision could not be accorded *res judicata* effect.

In a later, unrelated case, the supreme court provided further explanation for its rationale:

[W]hen the Legislature defines its policy and prescribes a standard as it has in the act in question, it may leave to the executive boards and officers the determination of facts in order to apply the law. . . . An administrative officer charged with the administration of the laws enacted by the General Assembly necessarily exercises a discretion partaking of the characteristics of the judicial department of the government, but does not have the force and effect of a judgment. Unless an administrative officer or department is permitted to make reasonable rules and regulations, it would be impossible in many instances to apply and enforce the legislative enactments, and the good to be accomplished would be entirely lost.<sup>15</sup>

Apparently, *res judicata* was occasionally one of the effects which an administrative decision was not accorded.

The court’s reluctance to give full-blown effect to decisions stemmed in part, it seems, not from the procedural requisites necessary for *res judicata* to apply, but rather from the alien grounds—as a matter of decisional framework—upon which agency decisions are made. The reverse image of this principle is found in the time-honored principle of deference to agency expertise. For instance, the Indiana Supreme Court has written:

Where the legislature has created a fact-finding body of experts in another branch of government, their decision or findings should not be lightly overridden because we, as judges, might reach a contrary opinion on the same evidence. So long as the experts act within the limits of the discretion given them by the statute, their decision is final.<sup>16</sup>

In other words, the same policy motivating deference to agency expertise was actually a disincentive to applying *res judicata* to an agency decision. The *anima mundi* for an agency was its expertise in a given field; the

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14. *Id.* at 370, 184 N.E. at 181.

15. *Financial Aid Corp. v. Wallace*, 216 Ind. 114, 119-21, 23 N.E.2d 472, 475 (1939) (The *Financial Aid Corp.* court was reviewing a revised enabling statute of the Department of Financial Institutions in the face of various constitutional challenges. The court upheld the act.).

16. *Public Serv. Comm’n v. City of Indianapolis*, 235 Ind. 70, 79, 131 N.E.2d 308, 311 (1956).



agency was presumably created by the legislature to provide innovative and problem- or industry-specific answers to novel, complex issues. The principles of deciding issues on the narrowest possible factual and legal basis and adherence to prior decisions—lynchpins of the common law—were not necessarily proper for an administrative agency. Without this decisional framework, courts would not grant the conclusiveness to an administrative adjudication that was routinely granted to trial court adjudications.<sup>17</sup> Whether couched as a distinction between judicial and ministerial functions, as in *Trautman*, or located in the deference of courts to agency determinations, courts remained unsure of the proper “effect” to be given to an agency determination.

This problem, coupled with the issue of which function (either executive or legislative)<sup>18</sup> an agency was exercising, caused a continuing struggle with res judicata questions in the context of the weight to be given previous administrative adjudications. In the 1970’s res judicata’s usefulness in agency decisions received a new test: could res judicata bind an agency to its own prior decision? A trilogy of zoning cases from 1970 to 1974 presented three milestones in the field: (a) establishing res judicata by name as a doctrine to be dealt with in the administrative context, (b) shifting the focus of the doctrine’s applicability to the procedures attendant to the administrative decisional process, and (c) suggesting that, when an agency’s decision could be termed judicial in nature, there was no serious impediment to granting that determination res judicata effect.

The first case was *Broughton v. Metropolitan Board of Zoning Appeals*.<sup>19</sup> There, disappointed landowners sought judicial review of a zoning variance grant to adjacent landowners. The landowners argued, *inter alia*, that the zoning board had previously denied a variance petition for the same property and proposed use. Because there had not been a showing of any factual difference between the previous and present

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17. Agencies are not expected to apply fixed or unyielding rules or policies, it was argued, but rather to exercise discretion and ingenuity in working out a satisfactory solution for each new case; and it was concluded that, at least to the extent that the doctrine of stare decisis is founded on the notion that the law is unchanging, the classical doctrine of stare decisis does not square with the theory and practices of the agencies.

F. COOPER, STATE ADMINISTRATIVE LAW, 504 (1962).

18. See *Public Service Comm’n*, 235 Ind. 70, 131 N.E.2d 308 (1956). In resolving a standard of review issue, the supreme court pointed out that “rate-making is a legislative, not a judicial function, and even if a statute attempted to lodge such power in a court it would be unconstitutional.” *Id.* at 81, 131 N.E.2d at 312.

19. 146 Ind. App. 652, 257 N.E.2d 839, *reh’g denied*, 146 Ind. App. 652, 258 N.E.2d 866 (1970).



variance petitions, the landowners argued, there could be no change in the board's determination of the issue.

Although not validating the *res judicata* argument entirely,<sup>20</sup> the court of appeals wrote that a zoning board "should not indiscriminately or repeatedly reconsider a determination denying a variance absent a change of conditions or circumstances."<sup>21</sup> The burden to raise the issue and present evidence on it, the court held, fell upon the remonstrators seeking to show that circumstances indeed had not changed.<sup>22</sup>

In *Easley v. Metropolitan Board of Zoning Appeals*,<sup>23</sup> the court of appeals revisited the burden of proof issue created by *Broughton*. The *Easley* court was faced with the issue of how remonstrators could prove a change in circumstances when the reasons for the prior variance denial were not a matter of public record. To remedy this problem, the court imposed upon the zoning boards the requirement that, "in all future cases and in those pending or in which the determination has not become final, it [the board] should specify by factual finding or by a statement of reasons the basis for denial of the variance petitions."<sup>24</sup>

The final case of the trilogy, decided between *Easley* and *Broughton*, was *Board of Zoning Appeals v. Sink*.<sup>25</sup> Unlike *Easley* and *Broughton*, *Sink* did not involve a quasi-*res judicata* effect as between two agency decisions. Instead, the issue presented in *Sink* was whether a remonstrator could use a previous, unappealed trial court judgment, which reversed a variance grant, to gain reversal of the board's granting of a second, similar petition without following the required procedure for direct judicial review.

Of crucial importance in *Sink* is the court's statement that "[m]ost courts have viewed the granting or denying of variance by Boards of Zoning Appeals as a quasi-judicial determination and have applied the doctrine of *res judicata* to their decisions. This is the law in Indiana."<sup>26</sup>

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20. The court suggested that there were other instances where "the doctrine of *res judicata* is clearly applicable." *Id.* at 659, 257 N.E.2d at 843; *see also id.* at 658 n.2, 257 N.E.2d at 842 n.2.

21. *Id.* at 658, 257 N.E.2d at 842.

22. *Id.*

23. 161 Ind. App. 501, 317 N.E.2d 185 (1974).

24. *Id.* at 512, 317 N.E.2d at 192. The court went on to state: "Thereafter, remonstrators against subsequent variance petitions may successfully assert a defense in the nature of *res judicata* by merely establishing the fact of the prior denial unless the petitioner proves that there has been a change in the conditions, circumstances or facts which induced the prior denial." *Id.*

25. 153 Ind. App. 1, 285 N.E.2d 655 (1972).

26. *Id.* at 8, 285 N.E.2d at 659. The court cited *Broughton* for the latter proposition; the court also cited *Beaven v. Village of Palatine*, 22 Ill. App. 2d 274, 160 N.E.2d 702 (1959); *Turf Valley Assocs. v. Zoning Bd. of Howard Co.*, 262 Md. 632, 278 A.2d 574 (1971); *In re Clements' Appeal*, 2 Ohio App. 2d 201, 207 N.E.2d 573 (1965).



The court held that the remonstrators could not bypass the administrative agency (and judicial review of the agency's actions) and assert res judicata directly before the trial court rendering the first decision. Instead, it was incumbent upon the remonstrators to establish the elements of the quasi-res judicata defense, as outlined in *Broughton*, before the agency in the first instance. Review of the agency's decision on the res judicata issue could then be had by normal routes of judicial review.<sup>27</sup>

*Sink*, when read in conjunction with its policy statements concerning the salutary effects of res judicata,<sup>28</sup> establishes res judicata as a method of either attacking or defending an agency decision. *Sink* also suggests that so long as the decision is quasi-judicial, res judicata must be dealt with. *Broughton* and *Easley*, focusing on how the board may find changed circumstances and on the precise contours of the change in circumstances (in the context of zoning) which will justify a different result, evidence a shift toward ensuring that re-litigation can be had when procedures are not in place which allow review and understanding of the original decision. Res judicata effect will not be given to an agency decision which cannot be explained or understood. For instance, there must be a statement of reasons for the denial of the variance under *Easley*. By the same token, perhaps, res judicata effect will not be given to an agency decision which has not followed proper procedure for decision-making. In other words, *Broughton* and *Easley* may have foreshadowed a subtle shift toward procedure over deference to the substantive nature (i.e., expertise) of the agency decision.

### B. United States Supreme Court History

The seminal case in United States Supreme Court pronouncements is relatively recent. In 1966, the decision in *United States v. Utah Construction & Mining Co.*<sup>29</sup> explicitly validated for the first time granting administrative decisions res judicata effect. In *Utah Construction*, the issue was, in its simplest form, whether the decision of the Advisory Board of Contract Appeals was entitled to res judicata effect in a subsequent suit in the Court of Claims. The Court of Claims ordered

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27. *Sink*, 153 Ind. App. at 8, 285 N.E.2d at 659.

28. The court noted that the bar on re-litigation of disputes formerly decided is a matter of public policy, and is based upon economies of time and fairness to parties. *Id.* at 7, 285 N.E.2d at 658-59. The *Sink* court's statements must be limited to the context of that case: whether res judicata effect for a trial court—not agency—decision could effectively short-circuit the administrative review process. Nonetheless, given the positive statement by the court that res judicata would apply to agency quasi-judicial determinations, there can be little doubt that the same benefits which obtain from res judicata in a court would also, in the *Sink* court's view, apply to an agency decision.

29. 384 U.S. 394 (1966).



that the contractor's delay claims (for contract price adjustment and time extension) be heard in a trial *de novo*, rather than based solely upon the administrative record before the Advisory Board of Contract Appeals.<sup>30</sup>

The Supreme Court's holding was ostensibly based on the Wunderlich Act of 1954, which required that decisions of the agency should be final, absent extreme circumstances.<sup>31</sup> The Supreme Court went beyond this, however, to reach the general *res judicata*<sup>32</sup> issue as developed by common law. The Court boldly stated:

Occasionally courts have used language to the effect that *res judicata* principles do not apply to administrative proceedings, but such language is certainly too broad. When an administrative agency is acting in a judicial capacity and resolves disputed issues of fact properly before it which the parties have had an adequate opportunity to litigate, the courts have not hesitated to apply *res judicata* to enforce repose.<sup>33</sup>

This declaration seems at odds with the authority cited but appears to have been intentionally created for future application to cases where the issue was more directly presented.

Professor Davis suggests that the statement was by no means mere *obiter dictum*. Instead, he writes, "The statement was carefully crafted. Each detail has significance."<sup>34</sup> Review of the primary authority of the *Utah Construction Court, Sunshine Anthracite Coal Co. v. Adkins*,<sup>35</sup> bears this premise out. Sunshine Anthracite petitioned the National Bituminous Coal Commission for a determination that its coal was not subject to the Commission's jurisdiction. The petition was denied; Sunshine then unsuccessfully sought judicial review of the commission's decision. Later, the Internal Revenue Service sought to collect taxes based on the fact that Sunshine actually produced bituminous coal. In the Supreme Court's opinion, *res judicata* effect was given to the court

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30. *Utah Constr. & Mining Co. v. United States*, 339 F.2d 606, 609-10 (Ct. Cl. 1964).

31. The statute provided that "any such decision shall be final and conclusive unless the same is fraudulent [sic] or capricious or arbitrary or so grossly erroneous as necessarily to imply bad faith or is not supported by substantial evidence." 384 U.S. at 399 (quoting 41 U.S.C. § 321 (1964)).

32. The precise issue before the Court was one of collateral estoppel: whether the factual findings of the board were conclusive in the subsequent litigation of the alleged breach of contract. *Utah Constr.*, 384 U.S. at 400. For convenience, the discussion herein is of *res judicata* generally.

33. *Id.* at 421-22.

34. K. DAVIS, *ADMINISTRATIVE LAW TREATISE* § 21:2, at 49 (1983).

35. 310 U.S. 381 (1940).



decision which reviewed the Bituminous Coal Commission decision,<sup>36</sup> not the Bituminous Coal Commission decision itself.

The distinction may at first appear to be of little significance. Yet the previous *court* judgment allowed the *Sunshine Anthracite* Court to speak in terms of *res judicata* with little difficulty. The Court spoke in terms of "a judgment" rendered in "each of these two suits." In the Court's view, this made the key issue "whether or not in the earlier litigation the representative of the United States had [the] authority to represent its interests in a final adjudication of the issue in controversy."<sup>37</sup> Consequently, the Court found unassailable the Coal Commission's authority to decide the matter and then enter the subsequent litigation. With those two conclusions reached, the ultimate conclusion was clear: the court decision, affirming the Bituminous Coal Commission, bound both the commission and the Internal Revenue Service because a judicial decision which binds the United States binds all its agencies.<sup>38</sup>

The decision in *Sunshine Anthracite* is, in this light, much removed from the *Utah Construction* decision. *Utah Construction* involved making final an agency decision in a subsequent court case; *Sunshine Anthracite* was effectively a case of one court judgment being given preclusive effect in a subsequent court case. Professor Davis continues with his evaluation of *Utah Construction*:

The only part of the statement that is subject to doubt is that "the courts have not hesitated. . . ." It should be interpreted to mean that the Supreme Court did not hesitate in the *Utah Construction* case, for the Supreme Court before that case did a good deal of hesitating.<sup>39</sup>

It is, then, appropriate to take the *Utah Construction* Court's statement in smaller pieces. The pre-requisites to giving *res judicata* effect to an agency decision are four-fold.<sup>40</sup> First, the agency must be acting in judicial capacity. Legislative actions by the agency, such as rulemaking, do not fall within the limits of the administrative *res judicata* doctrine. So, too, may decisions which require agency expertise and are perhaps not attended by trial-type procedures.

Second, the agency must be resolving disputed issues of fact. At first blush, the requirement seems to be derivative of the first, because determination of the historical facts (to which the law is then applied) seems at the core of the judicial function. However, the statement may

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36. *Id.* at 403-04.

37. *Id.* at 403.

38. *Id.*

39. K. DAVIS, *supra* note 34, § 21:2, at 49.

40. *United States v. Utah Constr. & Mining Co.*, 384 U.S. 394 (1966).



be less innocuous than it seems. The effect to be given to an agency decision may extend only to the brute, cold, historical facts—the actual events which transpired. Evaluative facts, those shading more toward legal conclusions, along with the legal conclusions, may not be subject to a *res judicata* effect. The distinction between giving *res judicata* effect to fact findings but not legal conclusions may separate administrative *res judicata* from the court-oriented *res judicata*.<sup>41</sup>

Thirdly, the fact issues must have been “properly before” the administrative agency. Apparently, jurisdictional defects at the agency level, and perhaps even procedural, non-fundamental defects in the agency’s decisional process will prevent using the agency decision in subsequent litigation. The *Utah Construction* Court noted that if an agency gratuitously made findings on an issue, even an issue over which it had jurisdiction, “such findings would have no finality whatsoever.”<sup>42</sup> Consequently, an agency decision, even if all the remaining prerequisites are met, still may not be entitled to preclusive effect. A search for procedural defects lurking behind the administrative record, as well as the scope of the issues actually litigated, is necessary for a determination of whether an agency decision is actually the final determination of the issue.

Fourth, the parties before the agency must “have had an adequate opportunity to litigate” the disputed issues of fact.<sup>43</sup> Actual utilization of the opportunity need not be afforded. Nevertheless, the issue does not end there. Requisites for procedural due process certainly figure in the calculus, as does the nature of the administrative state, where many dispositions are made without hearing, without the presence of the affected party, and probably without the presence of counsel.

Obviously, superimposing additional prerequisites to use of *res judicata* for agency decisions is designed to promote some control over subsequent use of administrative decisions while at the same time encouraging “the parties to make a complete disclosure at the administrative level, rather than holding evidence back for subsequent litigation.”<sup>44</sup> This background sets the stage for understanding and analyzing the Indiana Supreme Court’s decision in *McClanahan v. Remington Freight Lines, Inc.*<sup>45</sup>

### III. THE *McCLANAHAN* CASE<sup>46</sup>

John McClanahan drove a truck for Remington Freight Lines, Inc., an Indiana company. McClanahan, who started work in November 1981,

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41. See RESTATEMENT (SECOND) OF JUDGMENTS § 27 (1982). See also K. DAVIS, *supra* note 34, at 51.

42. *Utah Constr.*, 384 U.S. at 419 n.15.

43. *Id.* at 422.

44. *Id.* at 420.

45. 517 N.E.2d 390 (Ind. 1988).

46. The facts in this section are taken from the Court of Appeals decision, 498



had no contract of employment. McClanahan was travelling from New York to Minnesota, carrying a load that weighed 78,000 pounds. Federal law allowed 80,000 pound loads; Illinois allowed only 75,000 pound loads. Before reaching Illinois, McClanahan called the safety director for Remington, Richard Barbour, and told him that the load was too heavy.

Barbour told McClanahan that the company would pay any fine he incurred and that he probably would not be caught in any event. McClanahan continuously refused to drive through Illinois. McClanahan drove back to Remington's terminal, on orders from Remington. When he returned, McClanahan was fired; Remington's employee manual defined his termination as a "voluntary quit."

McClanahan applied for unemployment benefits. The initial application was refused, without hearing. McClanahan pursued an appeal to the Indiana Employment Security Division's Appellate Section. A hearing was held at which McClanahan and Barbour both testified. The hearing officer reversed the initial determination, holding that McClanahan was not discharged for just cause. He was therefore entitled, the hearing officer held, to unemployment compensation. No appeal was taken to the Indiana Employment Security Division's full board from the hearing officer's order.

Having secured his unemployment compensation benefits, McClanahan then instituted a separate action against Remington and Barbour in the Tippecanoe County Superior Court. He alleged retaliatory and wrongful discharge. Both McClanahan and Remington moved for summary judgment. McClanahan argued that re-litigation of the reasons for his discharge was not permitted: the decision of the hearing officer was collateral estoppel in the court case as to the facts causing his discharge. Remington sought summary judgment on the ultimate merits of the case: McClanahan was an employee at will and could be terminated for any (or no) reason and hence had no cause of action. The trial court granted Remington's motion and denied McClanahan's.

The Second District of the Indiana Court of Appeals reversed the grant of summary judgment in Remington's favor, and affirmed the denial of McClanahan's motion. On the first issue, the court held that "if, as *Frampton v. Central Indiana Gas Co.* clearly holds, an employee cannot be discharged solely for exercising a statutory right, logic and justice compel us to hold that an employee cannot be discharged solely for refusing to breach a statutorily imposed duty."<sup>47</sup>

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N.E.2d 1336 (Ind. Ct. App. 1986), and the Indiana Supreme Court's opinion on transfer, 517 N.E.2d 390 (Ind. 1988).

47. 517 N.E.2d at 392 (quoting *Frampton v. Central Ind. Gas Co.*, 260 Ind. 249, 297 N.E.2d 425 (1973)).



On the second issue, whether the reasons for McClanahan's discharge were relitigable, the court held that McClanahan had not presented a sufficient evidentiary basis for the imposition of collateral estoppel. The decision of the appeals referee (hearing officer) was not certified and could not be properly considered by the trial judge in determining the summary judgment motion. The appeals court found that the transcript of the proceedings before the hearing officer did not contain the hearing officer's decision and was thus an insufficient basis upon which to base a summary judgment ruling.

However, the court chose to address the general collateral estoppel issue because of its likely recurrence on remand. The court concluded that the decisions of the Indiana Employment Security Division could be given *res judicata* effect. Acknowledging the procedures for notice, evidentiary record, oaths, and subpoenas in the appeals referee hearing, the court determined that the proceedings were judicial in nature, particularly in view of the appeals referee's authority to affirm, modify or reverse the previous determination.

In a footnote, the court suggested some instances in which the agency decision was not to be accorded collateral estoppel or *res judicata* effect.<sup>48</sup> Noting that collateral estoppel effect is not proper when convincing reasons are advanced why the agency decision should not be final, the court of appeals suggested a total failure to observe procedural safeguards or a consideration of inadmissible evidence might be such a convincing reason. Nevertheless, the court held that, the appeals referee's decision, upon a proper evidentiary foundation, was entitled to collateral estoppel effect in this case.

The Indiana Supreme Court granted transfer.<sup>49</sup> The court affirmed the lower court's holding that McClanahan had stated a valid cause of action. The court also addressed the collateral estoppel issue because of its likely recurrence. Unlike the court of appeals, the Indiana Supreme Court declined to give the appeals referee's decision collateral estoppel effect. The high court adopted the following analysis for the issue: "1) whether the issues sought to be estopped were within the statutory jurisdiction of the agency; 2) whether the agency was acting in a judicial capacity; 3) whether both parties had a fair opportunity to litigate the issues; [and] 4) whether the decision of the administrative tribunal could be appealed to a judicial tribunal."<sup>50</sup> The application of this analysis of the facts before the court is critical to an informed understanding of *McClanahan's* effect on later cases involving collateral estoppel and administrative decisions.

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48. 498 N.E.2d at 1343 n.8.

49. 517 N.E.2d at 391.

50. *Id.* at 394.



IV. ANALYSIS OF *McCLANAHAN*

The first and foremost task in analyzing *McClanahan* is to examine its underlying rationale and determine whether there is any basis in law for the result reached by the supreme court. Besides the two Indiana cases cited in the opinion, *South Bend Federation of Teachers v. National Education Association*<sup>51</sup> and *Cox v. Indiana Subcontractors Association, Inc.*,<sup>52</sup> the primary basis for the court's result was engendered by the federal district court case of *Gear v. City of Des Moines*.<sup>53</sup> In that case, where the factual situation<sup>54</sup> was very similar to that present in *McClanahan*, the trial court set forth four elements which must be fulfilled by a prior administrative decision before its collateral application to a related civil rights claim. The Indiana Supreme Court faithfully reproduced those elements in its own inquiry into *McClanahan*'s case: (1) the matters at issue must be within the agency's statutory jurisdiction; (2) the agency had to function judicially; (3) both parties had to have a fair opportunity to litigate the issues; (4) the administrative decision must be appealable.<sup>55</sup> The *Gear* court found the Iowa Job Service's decision worthy of collateral estoppel effect; the Indiana Supreme Court applied these same four factors to the decision of the Indiana Employment Security Division and found it wanting.

This result is difficult to justify because the Iowa agency's procedures were almost identical to the Indiana agency's, even to the extent that there is no trial *de novo* on disputed issues of fact. This result is also difficult to justify because of the four elements themselves. There is one statement in *Gear*, however, which is particularly illuminating and clearly justifies the decision rendered by the Indiana court: "Additional related factors which must figure in the court's analysis include the deference accorded opinions of a particular administrative entity by the state courts, the intention of that entity and the expectations of the parties regarding judicial retrial of factual questions determined in administrative proceedings."<sup>56</sup> Although not specifically endorsed by the *McClanahan* court,

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51. 180 Ind. App. 299, 389 N.E.2d 23 (Ind. Ct. App. 1979).

52. 441 N.E.2d 222 (Ind. Ct. App. 1982).

53. 514 F. Supp. 1218 (S.D. Iowa 1981).

54. In *Gear*, a female former police officer was denied unemployment compensation upon a factual finding that she had left her employment voluntarily and without good cause. In her later lawsuit for relief under 42 U.S.C. §§ 1983 and 1985 and the fourteenth amendment of the United States Constitution, the defendants attempted to erect the Iowa Department of Job Service's finding as collateral estoppel to further litigation of the facts dispositive of her civil rights action. On the basis of the procedures before the Department, the United States District Court for the Southern District of Iowa, granted summary judgment in favor of the defendants on the matter of collateral estoppel. *Id.*

55. 517 N.E.2d 390, 394 (Ind. 1988).

56. 514 F. Supp. at 1221.



it is very apparent that these considerations weighed more heavily in its decision than the enumerated criteria. Thus, the court could freely state that, despite the obvious *opportunity* for review as required by the fourth factor, it considered instead the fact that it was "altogether likely that Remington *would have* pursued the appeal had it known McClanahan's intent to file a civil action for substantial damages."<sup>57</sup> How else to explain the cavalier treatment of the administrative procedures, procedures which are, by law, required to be informal in order to relieve the burden on trial courts? The *McClanahan* court obviously rendered only lip-service to the factors listed by the *Gear* court and instead determined that the defendants had neither a full nor fair opportunity to litigate the factual issue before the division on the premise that to decide otherwise would be inequitable because they had not taken full and fair *advantage* of the opportunity actually offered them. As critical as that statement may seem, it is not altogether clear that the *McClanahan* court did not reach the correct result in any event, regardless of its failure to acknowledge the *Gear* elements.

One must first re-examine the substance of the elements the *Gear* opinion posited for application of collateral estoppel in the agency-judiciary context. (These four factors are not to be confused with the four integral parts of the essential collateral estoppel inquiry itself.)<sup>58</sup> Primarily, a court is to look at the nature of the proceeding, the due process offered the parties (opportunity to litigate and opportunity for review), and the agency's jurisdiction over the issue in question. The standard for application of these factors is tempered "selectively and with a greater degree of flexibility"<sup>59</sup> than is afforded the traditional application of res judicata of judicial decisions. The problem with this approach on collateral review of agency decisions is that it is directly contrary to the well-established standard of judicial review of agency decisions on direct review.

It is well-settled by both statute and case law that on direct appeal from an administrative decision, a court has only limited review of that decision. However, it is interesting that the criteria governing that review bear a more than coincidental resemblance to the *Gear* factors. By statute, an Indiana court may grant relief from an agency decision only

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57. 517 N.E.2d at 395 (emphasis added).

58. There are four basic elements of res judicata: (1) the former judgment must have been rendered by a court of competent jurisdiction; (2) the matter now in issue was, or might have been, determined in the former suit; (3) the particular controversy previously adjudicated must have been between the parties to the present suit or their privies; and (4) the judgment in the former suit must have been rendered on the merits. *Cox v. Indiana Subcontractors Ass'n, Inc.*, 441 N.E.2d 222, 225 (Ind. Ct. App. 1982).

59. *Gear*, 514 F. Supp. at 1221.



if its action is (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; or (5) unsupported by substantial evidence.<sup>60</sup> The common law ingredients, for those agencies not governed by the Administrative Adjudication Act,<sup>61</sup> are the same.<sup>62</sup> Distilled to their essence, the direct review criteria are almost the same as those set forth in *Gear*: Did the agency have jurisdiction? Did the agency afford the aggrieved party due process? Was the decision void for any reason supplied by the law? It is apparent there is very little to distinguish the items a court considers on direct review of an administrative adjudication from those used in *Gear* and *McClanahan* in determining whether to allow its collateral use except the actual application of those factors.

The critical difference between the two applications is that on direct review, courts are inclined to give much greater deference to the decision of the agency<sup>63</sup> than the supreme court did in the *McClanahan* case. In other words, on direct appeal, an agency determination is more likely to be upheld on the very same notions that make it *unlikely* it will be given effect in a collateral matter. Therefore, a party stands a much greater chance of being bound by such a decision if he takes the matter directly for review than if he opts to take his chances in a different proceeding involving the same issues before the agency. The *McClanahan* opinion, if nothing else, gives an aggrieved party another opportunity to relitigate the issues and to succeed on the merits, when the agency decision has been otherwise unfavorable. On collateral matters, the agency decision is less likely to prohibit the trial court from retrying the very same case whereas *de novo* relief is not typically available in judicial review.<sup>64</sup>

This lack of symmetry in the application of the same factors to the same sort of decision but with different results is troublesome. There appear to be three solutions to this problem. One could dispense with

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60. IND. CODE § 4-21.5-5-14(d) (1988).

61. IND. CODE §§ 4-21.5-1-1 to -2-4 (1988).

62. See, e.g., *Tilton v. Southwest School Corp.*, 151 Ind. App. 608, 281 N.E.2d 117 (1972).

63. See e.g., *New Trend Beauty School, Inc. v. Indiana State Bd. of Beauty Culturist Examiners*, 518 N.E.2d 1101 (Ind. Ct. App. 1988); *Drake v. City of Gary*, 449 N.E.2d 624 (Ind. Ct. App. 1983).

64. IND. CODE § 4-21.5-5-11 (1988) sets forth the following limitation on the introduction of evidence upon judicial review of an administrative decision: "Judicial review of disputed issues of fact must be confined to the agency record for the agency action supplemented by additional evidence taken under section 12 of this chapter. The court may not try the cause *de novo* or substitute its judgment for that of the agency.



the *Gear* criteria altogether in matters of collateral attack and consider only the four basic elements of collateral estoppel itself. The *McClanahan* court obviously followed this course. Or one could apply the factors in matters of collateral attack in the same fashion they are treated on direct judicial review. Lastly, one could formulate a different set of criteria than those set forth by the *Gear* and *McClanahan* decisions.

With the first solution, a trial court would simply apply the four basic elements of collateral estoppel<sup>65</sup> but would also determine whether the agency's decision was sufficiently congruent with trial proceedings to grant it the deference due to judicial decisions. This format, for which there is already established precedent in *McClanahan*, has a practical appeal to it. Unless the parties' expectations evince otherwise, it could be presumed that they did not grant sufficient weight to the informal proceedings before the administrative agency to make them be bound by its decisions in a collateral judicial matter that may very well have greater ramifications. For instance, McClanahan's claim for unemployment compensation, garnering as it did only a minimal economic award, could not have presaged to his employer that a larger wrongful discharge suit lurked in the wings. Therefore, as is their wont, the parties probably took the entire proceedings before the Employment Security Division much more lightly, given the informality and routine nature of the proceedings. On the other hand, a matter before the Medical Licensing Board has a greater potential for grave consequences and for greater care and preparation by the parties. A decision by the Licensing Board is more likely to deprive a party of property and liberty rights to which specific due process protections inhere. Therefore, that agency is more likely, as a matter of course, to conduct traditional judicial proceedings although perhaps somewhat more informally as allowed by statute. Under the *McClanahan* rationale, which is dependent upon whether the hearing "differed substantially from a traditional courtroom proceeding,"<sup>66</sup> greater credence would therefore be given a Board decision than the one at issue in *McClanahan* and collateral estoppel principles more likely effected.

This result may appear to be in derogation of the whole purpose for creating agencies in the first place—to delegate certain judicial responsibilities to governmental entities with expertise in specific areas of the law. *McClanahan* might be read to suggest such a "cavalier" result inasmuch as some agency decisions could fall by the wayside upon collateral attack because their proceedings are not conducted as if in a courtroom, nor were they conceived to be. However, the likelihood of

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65. See, e.g., *Hardesty v. Bolerjack*, 441 N.E.2d 243, 245 (Ind. Ct. App. 1982).

66. 517 N.E.2d at 394-95.



any great number of decisions reaching the posture present in *McClanahan* seems very remote—there are only two such scenarios in contemporary Indiana case law, *McClanahan* and *Cox*.<sup>67</sup> In addition, it is not unlikely that the expectations of the parties could be better served by a “retrial” on the merits. Otherwise, agency decisions may end up as formalistic as judicial proceedings in order to forestall unexpected collateral attacks, an outcome not contemplated when the delegation of judicial duties was imposed upon agencies. The *McClanahan* opinion may therefore be more in line with current attitudes regarding collateral review of agency decisions than its lack of reliance on *Gear* might imply.

The second alternative would be to apply the already established direct review criteria as pronounced by *Gear* uniformly to both direct attacks on administrative decisions, via judicial review, and collateral attacks. The simplicity in applying this standard is apparent when one contemplates the wealth of case law from which the courts could draw in the context of judicial review. In addition, applying the *Gear* standard would accord to agency decisions the dignity to which they are entitled by reason of their fact-finding function. This posture, of course, would make *McClanahan* and *Cox* incorrectly resolved.

The primary motivation for wielding an agency decision as a weapon in a judicial collateral attack, be it offensively or defensively, is to expedite proceedings. If a fact at issue has been already determined before a trier of fact, *i.e.*, the administrative agency, there seems no reasonable need to retry the matter before yet another trier of fact. And this is the crucial point that the *Cox* and *McClanahan* courts appeared to miss. The only branch of *res judicata* amenable for use in the administrative context is issue preclusion/collateral estoppel. Estoppel by judgment is out of the question for the very reason that agencies were established—they dispense specialized remedies not available to trial courts. There could be no estoppel between the judgment of a trial court and the decision of an agency. That therefore leaves, by default, collateral estoppel as the *res judicata* tool used by trial courts when confronted with the resolution of the same or similar issues by an agency.

The *Cox* court evinced no understanding of this tenet when it challenged the agency’s expertise to decide contract issues. That expertise is beside the point because that was never the “issue” before the Employment Security Division. Rather, the Division determined that *Cox* had been terminated for just cause by his employer. When his employer attempted to use the fact of his statutorily lawful termination in *Cox*’s breach of contract action, such fact was apparently to be used simply as one established element among many in the civil litigation. There is

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67. *Cox v. Indiana Subcontractors Ass’n*, 441 N.E.2d 222 (Ind. Ct. App. 1982).



no intimation from the case's presentation of the facts that Cox's proper termination was *ipso facto* a determination of his contract claim. Rather, the agency's finding of fact might have been used in the Association's defense of Cox's claim—to justify the employer's alleged breach if indeed such breach existed at all. In any event, it is clear the Cox case misunderstood the use of the agency's finding and misunderstood the basic concept of collateral attack in the agency-judiciary context.

The court in *Shortridge v. Review Board of Indiana Employment Security Division*,<sup>68</sup> however, was right on target when it held that an agency's *findings of fact* are binding on collateral attack. This principle is what some courts seem to lose sight of when they encourage giving less deference to agency decisions than to judicial decisions. The only application for agency determinations in court cases is in the matter of fact-finding. Fact-finding is not a specialized area reserved for the expertise of trial courts. Indeed, it is the basic function of agencies to render certain specialized remedies. Nevertheless, underlying those remedies are factual determinations. In fact, administrative agencies are typically required to consider three types of facts: *evidentiary facts* which form the foundation for their *basic findings of fact* upon which they determine their *ultimate findings of fact* (remedies).<sup>69</sup> Given the burden that agencies must bear with regard to the factual conclusions they must draw,<sup>70</sup> particularly for purposes of judicial review and despite the informalities inhering in their procedures, there seems no reason why their factual determinations should be given any less credence than a trial court's in the matter of collateral estoppel. A trier-of-fact is a trier-of-fact. There is simply no rational explanation for not honoring that role in the determination of the credibility of witnesses and weighing of evidence for purposes of establishing factual matters on collateral attack. As discussed above, it is expected from the agencies as a matter of law on direct attack by judicial review. And courts give deference to it. As a consequence, there also seems no rational reason why the *Gear* criteria cannot be applied with the force used in judicial review when a court is confronted with an agency decision on collateral attack.

As a third alternative, one could formulate a different set of rules. In light of the conclusions regarding the other two alternatives, that

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68. 498 N.E.2d 82 (Ind. Ct. App. 1986).

69. See, e.g., *Perez v. United States Steel Corp.*, 426 N.E.2d 29, 33 (Ind. 1981) ("[F]indings of basic fact must reveal the Board's analysis of the evidence and its determination therefrom regarding the various specific issues of fact which bear on the particular claim. The 'finding of ultimate fact' is the ultimate factual conclusion regarding the particular claim before the Board.").

70. *Id.*



would hardly seem a useful exercise. The embryo for the notion that administrative *res judicata* even needed an independent set of rules was formed in Professor Davis' well-recognized treatise on administrative law.<sup>71</sup> Professor Davis' premise was that administrative agencies often work with fluid facts and shifting policies.<sup>72</sup> How an agency's function in this regard differs significantly from that of a trial court is difficult to discern, but evidently Davis was concerned more with the agency-agency decisions rather than agency-judiciary matters. Agencies, being creatures of politics, are often governed by the vagaries of patronage in each administration resulting in new board memberships, and consequently, new agendas. Regardless, a set of rules would be useful, if focused on the proper goal, in order to confront more objectively other situations such as that which arose in *McClanahan*.

A framework for formulating a set of rules in the collateral use of agency decisions in a later lawsuit should adopt portions of the first two solutions discussed above but as a distinct permutation entire unto itself. Actually, the *McClanahan* court contributed to such a set of rules, albeit perhaps unwittingly. The first element is that which sets agencies apart from judicial tribunals in the first instance—the identification of the agency function. (1) Did the agency act in a judicial capacity (as opposed to its legislative capacity)? Once that is determined in the affirmative, the trial court simply applies the remaining three nonjurisdictional elements of collateral estoppel: (2) Did the agency decision involve and bind the same parties or their privies? (3) Was the agency decision final, *i.e.*, unreviewed? (4) Was the issue at hand actually "litigated" and essential to the agency's decision?<sup>73</sup> The rules look familiar; however, the first step—which sets agency decisions apart from trial court judgments—has its own considerations.

Whether the agency acted in a judicial capacity is not an inquiry that goes deep enough. It was not even an inquiry that the *McClanahan* court took at face value. Although *McClanahan* and his employer took part in a judicial proceeding, it was simply not "judicial" enough. In reaching that conclusion, the supreme court looked at the parties' expectations and the actual occurrence of events before the agency. That approach is not entirely bad because the right result was reached in the *McClanahan* decision. However, the subjective element of the parties' expectations is simply too uncertain to use as an appropriate element of the judicial nature of an agency proceedings.

Rather, the emphasis on the judicial capacity of the agency should center on an objective inquiry as to what actually happened before the

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71. DAVIS, *supra* note 34, at §§ 18.01, 18.04.

72. *Id.*

73. *McClanahan*, 517 N.E.2d at 394.



agency and on whether those events comport with our notions of a judicial function. Those investigations must take into account the legislatively mandated informality of such proceedings, and the measure of that informality would also have a direct relationship to the parties' expectations. Hence, the elimination of one of *McClanahan's* questions is the elimination of an ill-defined yardstick. What the trial court should be limited to is a review of the agency record and that record alone.

From the information therein, the court could determine (1) the adversarial nature of the proceedings, *i.e.*, did the parties actually litigate the issues in the case or was the issue so small that it was considered a *fait accompli* upon the presentation of the petitioner's case? Did the hearing examiner assist petitioner in the presentation of his case?; and (2) the due process accorded the parties, *i.e.*, how strictly did the hearing examiner adhere to the rules of evidence? Was cross-examination available? Was testimony under oath?

These two concerns were primary factors in the *McClanahan* decision and correctly so.<sup>74</sup> However, taking out the subjective elements of that opinion and limiting the trial court's assessment of the agency's judicial function to the actual record before it will confine the inquiry to the objective nature of the elements rather than making collateral estoppel decisions subject to the varying strengths of the parties' arguments dependent upon "if only I had known the consequences." Once this objective hurdle is crossed, the trial court then either denies estoppel effect to the decision outright or goes on to consider the remaining collateral estoppel elements. Simplistic by nature, these rules need not be anymore complicated. To do so would merely, and unnecessarily, obfuscate a doctrine which has enjoyed unparalleled success between trial court opinions without such subjective confusion.

#### V. APPLICATION OF *McCLANAHAN*

After having engaged in extensive analysis of *McClanahan*<sup>75</sup> and addressing its immediate ramifications *vis a vis* its actual application to cases of the same ilk, one must consider the effects, if any, this case will have on the whole broad spectrum of the matter of the *res judicata* effect to be given to administrative decisions in the judicial arena. Such an investigation entails consideration of other "current" Indiana cases, such as *South Bend Federation of Teachers v. National Education Association*<sup>76</sup> and *Cox v. Indiana Subcontractors Association, Inc.*,<sup>77</sup> as

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74. See *id.* at 395.

75. 517 N.E.2d 390 (Ind. 1988).

76. 180 Ind. App. 299, 389 N.E.2d 23 (1979).

77. 441 N.E.2d 222 (Ind. Ct. App. 1982).



well as of the manner in which the issue is presented to a court for review. Primarily, the distinction is whether a trial court is applying the doctrine between two decisions of the same agency or between an agency decision and a trial court proceeding. Indiana case law suggests that distinction makes a difference.

*South Bend Federation of Teachers* is more akin to the zoning cases discussed previously<sup>78</sup> because it consisted of the application of an agency decision to a later decision of the same agency. In the *South Bend* case, the matter was brought to a head in a judicial challenge to a decision of the Indiana Education Employment Relations Board (IEERB). One teachers' association (NEA) filed a Verified Complaint to enjoin IEERB from exercising jurisdiction over an election petition filed by a rival association (AFT). The basis for the complaint was a decision entered on March 25, 1977. The thrust of the complaint was that IEERB was bound to apply an earlier 1974 board decision in favor of NEA, rather than be allowed to issue a second decision in favor of AFT. In a well-reasoned opinion, presaging *Gear v. City of Des Moines*,<sup>79</sup> Judge Buchanan determined that no facts had intervened between the two IEERB decisions necessitating a change in position from the 1974 ruling, and the parties, as well as IEERB, were bound by the earlier declarations regarding the same factual determination material to both decisions<sup>80</sup>—the interpretation of an election agreement among the two associations and the school corporation.<sup>81</sup>

As with *McClanahan*, the court of appeals was confronted with a factual issue, thereby requiring the application of the collateral estoppel branch of *res judicata*, but with the twist that the factual determination was binding on the *agency* rather than upon a trial court. The trial court's function here was one more of review rather than of a *de novo* litigation of a distinct cause of action. Despite the ultimate holding in *McClanahan*, there is nothing to intimate that *South Bend Federation of Teachers* is defunct precedent, at least in the agency-agency context.

The second important case addressed by *McClanahan* is *Cox v. Indiana Subcontractors Association, Inc.*<sup>82</sup> The factual issues in the *Cox* case are very similar to those presented in *McClanahan*: Cox filed a claim for unemployment compensation before the Employment Security Division after he was terminated from his positions as director and board secretary for the Indiana Subcontractors Association.<sup>83</sup> The Di-

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78. See *supra* notes 19-25 and accompanying text.

79. 514 F. Supp. 1218 (S.D. Iowa 1981).

80. 180 Ind. App. at 318, 389 N.E.2d at 34.

81. *Id.* at 301, 389 N.E.2d at 25.

82. 441 N.E.2d 222 (Ind. Ct. App. 1982).

83. *Id.* at 224.



vision denied him benefits upon its determination that he had been terminated for just cause.<sup>84</sup> Cox then filed a suit against the Association for, among other things, breach of contract. In turn, the Association erected the Division's finding as *res judicata* on the issue. Like the *McClanahan* court, the *Cox* court examined the newly rendered opinion of *Gear v. City of Des Moines*<sup>85</sup> and, like the *McClanahan* court, held that *res judicata* was not applicable. The court of appeals held the doctrine inappropriate in this instance because "[it] is simply inapplicable to resolve a case as complex as the present one."<sup>86</sup> *Cox* and *McClanahan* are therefore congruent in result where they both reflect a disinclination to give deference to agency decisions in matters of judicial cognizance. However, the *Cox* result is disturbing because of its lack of rationale.

The most troubling aspect of the *Cox* decision is the utter lack of analysis of the *Gear* decision as it should have been applied to the matter at hand. There is no disputing that *Cox* probably set forth the appropriate standards of review as delineated in *Gear* in a more comprehensive fashion than did *McClanahan*. Unfortunately, such coverage does not explain the total lack of application of the *Gear* elements to the *Cox* facts. Rather, the court made the sweeping generalization that "[t]he Review Board [of the Employment Security Division] is not the proper authority to determine complex legal issues involving contract interpretation and tort issues."<sup>87</sup> Even if that proposition were true,<sup>88</sup> this declaration totally ignores the well-developed meaning of the collateral estoppel prong of *res judicata*: "when a particular issue is adjudicated and then is put into issue in a subsequent suit on a different cause of action between the same parties or those in privity with them."<sup>89</sup> Instead, the *Cox* court determined that a legal opinion rendered by the Division could not prevent relitigation of the same question in court.

The problem is that collateral estoppel is a fact-based principle rather than a law-based. The Division had made no contractual determination, only a determination of the reasons for Cox's termination, which *fact* would have been an essential element in the Association's defense of the breach of contract claim. In other words, the reliability of the *Cox*

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84. *Id.*

85. 514 F. Supp. 1218 (S.D. Iowa 1981).

86. *Cox*, 441 N.E.2d at 226.

87. *Id.* at 226.

88. *See, e.g.,* Metropolitan Dev. Comm'n v. I. Ching, Inc., 460 N.E.2d 1236, 1237 (Ind. Ct. App. 1984) ("It is . . . well settled that landowners seeking to raise the issue of [confiscation of property without just compensation] must exhaust their administrative remedies by presenting the constitutional issue to the Board of Zoning Appeals before invoking the aid of the courts.").

89. South Bend Fed'n of Teachers v. National Educ. Ass'n, 180 Ind. App. 299, 314, 389 N.E.2d 23, 32 (1979).



decision, as applied to the facts before it, is of questionable value although there is without doubt important ramifications for its use as a source of the law to apply when other significant cases arise dealing with the application of res judicata in the administrative-judicial context.

There also exists one other Indiana decision of a contemporary nature which is noteworthy, if for no other reason than that it sheds some additional light on our courts' willingness to apply the doctrine of res judicata with regard to agency decisions when the opportunity presents itself. In *Shortridge v. Review Board of Indiana Employment Security Division*,<sup>90</sup> collateral estoppel was utilized to require the Employment Security Division to abide by its own findings of fact rendered in 1977 when determining benefits to be awarded to the same claimant in 1984 proceedings.<sup>91</sup> The agency-agency application of res judicata was born of an analysis of *South Bend Federation of Teachers*.<sup>92</sup> However, what is interesting about this opinion is its divergence from the *Cox* case in its definitive reliance upon the collateral estoppel doctrine as applicable to findings of fact, and not just to the determination of singular legal questions as applied to those facts.

If one can say with any authority that there is a "pattern" to the manner in which Indiana courts will consider the doctrine of res judicata in giving estoppel effect to agency decisions, the likelihood of success is greater when the issue arises in the agency-agency relationship, as in *South Bend Federation of Teachers* and *Shortridge*. The philosophy inhering in those two cases is, succinctly, "if there is a reason to settle the issues involved once and for all,"<sup>93</sup> courts will not be loathe to apply estoppel-type principles to "guard parties against vexatious and repetitious litigation of issues which have been determined in a judicial or quasi-judicial proceeding."<sup>94</sup> Both opinions evince little or no patience for an agency's decision to reverse itself in subsequent proceedings where the legal questions and/or facts at issue remain essentially the same and where intervening events have not changed the circumstances upon which the initial findings were based.<sup>95</sup> Such philosophy, however, has not been translated into the agency-judiciary situation, where the courts seem more

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90. 498 N.E.2d 82 (Ind. Ct. App. 1986). See also *supra* notes 68-70 and accompanying text.

91. *Id.* at 91.

92. 180 Ind. App. 299, 389 N.E.2d 23 (1979). See *supra* text accompanying notes 78-81.

93. *South Bend Fed'n of Teachers*, 180 Ind. App. at 317, 389 N.E.2d at 34.

94. 180 Ind. App. at 318, 389 N.E.2d at 35; see also *Shortridge*, 498 N.E.2d at 90.

95. *South Bend Fed'n of Teachers*, 180 Ind. App. at 317, 389 N.E.2d at 34; *Shortridge*, 498 N.E.2d at 90.



reluctant to afford agency decisions the respect sufficient to estop later judicial determinations.

This attitude is best exemplified in *Cox*.<sup>96</sup> The deference ordinarily given by courts to administrative decisions and agency expertise<sup>97</sup> fell by the wayside when the court of appeals declared, "[t]he Review Board lacks the requisite training and experience to determine these matters."<sup>98</sup> That statement calls into question the manner in which an agency makes its factual determinations, especially because there seems to be no dispute but that collateral estoppel/issue preclusion, rather than estoppel by judgment, will be the manner of applying an administrative decision to a judicial cause of action. And the supreme court dealt handily with this very attitude toward such fact-finding expertise in *McClanahan*:

[N]either Remington nor Barbour had a full and fair opportunity to litigate the issue of whether McClanahan was discharged for refusing to commit an illegal act. . . . [T]he nature of the administrative hearing itself differed substantially from a traditional courtroom proceeding. The referee acted as the primary questioner, and neither party was represented by counsel. Cross-examination was minimal and ineffective. Inasmuch as the rules of evidence do not strictly apply to administrative proceedings, a substantial amount of hearsay potentially inadmissible at trial was introduced without objection.

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In light of all these circumstances, fairness requires that we not apply collateral estoppel. The relative informality of the particular administrative procedure at issue here does not meet the test used in *Cox*. It is a procedure designed for quick and inexpensive determinations of unemployment benefits.<sup>99</sup>

In essence, the supreme court implies that when an agency decision is brought for estoppel consideration before a court, its proceedings must be as nearly as akin to a judicial atmosphere as possible or its decisions will not merit application in a court of law. By the supreme court's very declaration that an agency's decision is specifically designed for "quick and inexpensive determinations" and by reason of the typically relaxed evidentiary and procedural requirements allowed in administrative

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96. See *supra* text accompanying notes 82-89.

97. See, e.g., *Capital Improvement Bd. of Managers v. Public Serv. Comm'n*, 176 Ind. App. 240, 259, 375 N.E.2d 616, 630 (1978) ("[A court] in reviewing the decision of an administrative body is not to substitute its own opinions and conclusions for those of the agency, but rather must give deference to the expertise of that agency.").

98. 441 N.E.2d at 226.

99. 517 N.E.2d at 394-95.



proceedings,<sup>100</sup> it is unlikely that administrative decisions will ever become an integral part of the collateral estoppel doctrine in Indiana within the judicial arena, despite the representations to the contrary in *McClanahan v. Remington Freight Lines, Inc.*

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100. IND. CODE § 4-21.5-3-25(b) (1988) provides:

“The administrative law judge shall regulate the course of the proceedings . . . in an informal manner without recourse to the technical, common rules of evidence applicable to civil actions in the courts.”

IND. CODE § 4-21.5-3-34 (1988) provides:

“An agency is encouraged to develop informal procedures that are consistent with this article and make unnecessary more elaborate proceedings under this article.







# Indiana Revised Uniform Limited Partnership Act

PAUL J. GALANTI\*

## I. INTRODUCTION

The most significant development in the area of Indiana business associations law during the past year was the enactment of the new Indiana Revised Uniform Limited Partnership Act<sup>1</sup> (IRULPA or "new Act") which is based largely on the Revised Uniform Limited Partnership Act of 1976, with 1985 amendments ("Model Act"). It also incorporates some features of the 1985 Delaware Limited Partnership Act,<sup>2</sup> ("Delaware Act") and reflects changes intended to parallel aspects of the Indiana Business Corporation Law<sup>3</sup> (IBCL) that became effective on August 1, 1987.

The IRULPA superseded the prior Indiana Uniform Limited Partnership Act (IULPA or "old Act")<sup>4</sup> which was enacted in 1949. The IULPA was based on the Uniform Limited Partnership Act (ULPA) promulgated in 1916. There were no reported cases arising under the IULPA until recently, and even now there have been only a few cases involving this statute. However, the use in Indiana of the limited partnership form of enterprise might increase under the modern, flexible, state of the art IRULPA.

The purpose of this Survey Article is to compare the new Act with the old Act and the Model Act. Before doing that, however, a brief introduction to limited partnerships is in order. The limited partnership is a business organization with attributes somewhere between the corporation and the general partnership.<sup>5</sup> There are two classes of partners in a limited partnership: any number of limited partners and at least one general partner charged with conducting the partnership's business. Limited partners are somewhat analogous to shareholders of a corporation because their liability for partnership obligations is limited to the amount

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\* Professor of Law, Indiana University School of Law—Indianapolis. A.B., Bowdoin College, 1960; J.D., University of Chicago, 1963.

1. IND. CODE §§ 23-16-1-1 to -12-6 (1988). Indiana has recognized limited partnerships since 1859. *See generally* Brown, *The Limited Partnership in Indiana*, 5 IND. L.J. 421 (1930).

2. DEL. CODE ANN. tit. 6, §§ 17-101 to 1108 (Supp. 1986).

3. IND. CODE §§ 23-1-17-1 to -54-3 (1988).

4. IND. CODE §§ 23-4-2-1 to -2-31 (repealed effective 1993).

5. *See generally* J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP § 26 (1968) [hereinafter CRANE & BROMBERG].



they have invested in the business. They differ from corporate shareholders, however, by being restricted in the degree they can take part or participate in controlling the partnership's business without risk of losing their limited liability status.<sup>6</sup> One major difference between the new and old Acts is that the limited partner's risk of being subjected to personal liability is much reduced under the IRULPA.

The general partner, or partners, in a limited partnership manage the business. They have the same rights, duties and liabilities as partners in a general partnership including unlimited liability for the obligations of the enterprise. Another distinction between general and limited partnerships is the formality necessary for organization. Here again the limited partnership is akin to the corporation because both require compliance with specific statutory provisions to be formed properly. In contrast, organizing a general partnership can be very informal. The formalities of organizing a limited partnership, however, have been simplified in the new Act as compared to the old Act.

## II. BACKGROUND AND APPLICABILITY OF IRULPA

The origins of limited partnerships can be traced back to the middle ages.<sup>7</sup> Two early common law decisions<sup>8</sup> holding that "profit sharing" alone was a ground for imposing liability for losses, created the need for a business form permitting investors to share profits with limited liability for losses and to invest capital without responsibility for management. The limited partnership is such a device, although a limited partner's protection against unlimited liability<sup>9</sup> is less secure than the protection given to a shareholder of a corporation.

Statutory authority is needed to form limited partnerships. Early statutes dating back 150 years often were strictly construed on the grant of limited liability.<sup>10</sup> Consequently, limited partnerships were not very common. Even the promulgation of the ULPA did not cause a substantial increase in the use of limited partnerships. They have been used, however,

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6. The elimination of this distinction has been seriously urged. See Basile, *Limited Liability for Limited Partners: An Argument for the Abolition of the Control Rule*, 38 VAND. L. REV. 1199 (1985); Kempin, *The Problem of Control in Limited Partnership Law: An Analysis and Recommendation*, 22 AM. BUS. L.J. 443 (1985).

7. CRANE & BROMBERG, *supra* note 5, § 26, at 143-44.

8. *Waugh v. Carver*, 2 H. Bl. 235, 126 Eng. Rep. 525 (1793); *Grace v. Smith*, 2 Wm. Bl. 998, 1000, 96 Eng. Rep. 587, 588 (1775). Eventually, these cases were overruled in England. *Cox v. Hickman*, 8 H.L. Cas. 268, 11 Eng. Rep. 431 (1860). See generally CRANE & BROMBERG, *supra* note 5, §§ 14(b), 26(a).

9. See *Klein v. Weiss*, 284 Md. 36, 395 A.2d 126 (1978); *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 665, 670, 80 A.2d 906, 908 (1951).

10. CRANE & BROMBERG, *supra* note 5, at 144 n.25.



with some frequency in real estate and oil and gas ventures<sup>11</sup> and in high-risk ventures such as theatrical enterprises where the parties want both limited liability and the conduit type of income tax treatment of partnerships.<sup>12</sup>

One reason for the limited use of the limited partnership form of business is that although the ULPA was an improvement over prior limited partnership statutes, it contained some ambiguous provisions, and other provisions created some serious practical problems for limited partnerships.<sup>13</sup> These problems prompted the National Conference of Commissioners on Uniform State Laws to promulgate the Model Act in 1976 "to modernize the prior uniform law while retaining the special character of limited partnerships as compared to corporations."<sup>14</sup> The

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11. See generally Lowell, *Organizing a Limited Partnership to Achieve Real Estate Investment Objectives in Indiana*, 48 IND. L.J. 369 (1973).

12. These deals were often organized to shelter income of individuals who would otherwise have to pay high income tax rates rather than as true profit making ventures which would increase the investors' taxes even more. Although limits on tax shelters imposed by the Tax Reform Act of 1976, and the reduction of the maximum tax bracket, should have reduced the incentive to invest in a "business" that produces nothing but tax losses, a Department of the Treasury study showed a dramatic increase from 1979 to 1982 in the number of tax shelter partnerships being used as a vehicle to reduce the tax liabilities of high income individuals. Nelson, *Taxes Paid by High-Income Taxpayers and the Growth of Partnerships*, INTERNAL REVENUE SERVICE STATISTICS OF INCOME BULLETIN (1985).

13. See Basile, *The 1985 Delaware Revised Uniform Limited Partnership Act*, 41 BUS. LAW. 571, 572 (1986).

14. Lamb, *Introduction—Symposium: Limited Partnership Act*, 9 ST. MARY'S L.J. 441 (1978). See also REV. UNIF. LIMITED PARTNERSHIP ACT commissioners' prefatory note, 6 U.L.A. 211-13 (Supp. 1988). No state adopted the RULPA for several years until the probable tax treatment of organizations formed under it could be ascertained. Once that issue was resolved, states started to adopt the RULPA and now it is the law in most jurisdictions.

Delaware did not adopt the original ULPA until 1973. It was the last state to adopt the act. The Delaware ULPA contained some nonuniform provisions designed to make Delaware an attractive jurisdiction in which to organize limited partnerships. The Delaware act adopted in 1982 also included nonuniform provisions for the same purpose. Delaware significantly amended its limited partnership act in 1985 shortly before the Commissioners adopted the 1985 amendments to the RULPA. Those amendments were intended to further refine the statute, in part in response to the changes the Delaware legislature made when it adopted the RULPA in 1982. Delaware, in turn, acted to provide an even "clearer and more flexible limited partnership act than the 1985 RULPA." Basile, *supra* note 13, at 573. Delaware clearly intends to be a state as attractive to large limited partnerships as it is to large corporations.

See generally Aslanides, Cardinali, Haynsworth, Lane & Niesar, *Limited Partnerships—What's Next and What's Left?*, 34 BUS. LAW. 257 (1978); Hecker, *The Revised Uniform Limited Partnership Act: Provisions Affecting the Relationship of the Firm and its Members to Third Parties*, 27 KANSAS L. REV. 1 (1978); Kessler, *The New Uniform Limited*



Commissioners' Prefatory Note points out that although a limited partnership can be more flexible than a corporation with respect to relations among the partners, the consensual relationship among partners requires more concurrence from passive investors than might be acceptable to corporate management.<sup>15</sup> Finally, the Commissioners point out that the limited partnership is an alternative to the corporation form of enterprise but that neither the ULPA nor the Model Act was intended to make the limited partnership appropriate in all cases where the corporate form is undesirable for tax or other reasons.<sup>16</sup>

A major difference between the old and the new Acts is that under the IULPA limited partnerships organized under prior statutes continued to be controlled by those statutes unless the partnership elected to come under that Act.<sup>17</sup> The IRULPA applies to all Indiana limited partnerships organized after its effective date of July 1, 1988.<sup>18</sup> Existing limited partnerships can "opt in" to the IRULPA by filing a new certificate of limited partnership with the secretary of state after July 1, 1988.<sup>19</sup> Unless otherwise agreed by all partners, the applicable provisions of the IULPA governing allocation of profits and losses, distributions to a withdrawing partner, and distribution of assets upon the winding up of a limited partnership govern limited partnerships formed before July 1, 1988.<sup>20</sup> However, after July 1, 1993, the IRULPA will apply to limited partnerships existing before July 1, 1988, regardless of whether the partnership opts in.<sup>21</sup> The IRULPA follows the approach of the drafters

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*Partnership Act: A Critique*, 48 *FORDHAM L. REV.* 159 (1979); *Symposium: Limited Partnership Act*, 9 *ST. MARY'S L.J.* 441 (1978); Note, *Investor Protection and the Revised Uniform Limited Partnership Act*, 56 *WASH. L. REV.* 99 (1980).

15. REV. UNIF. LIMITED PARTNERSHIP ACT commissioner's prefatory note, 6 *U.L.A.* 211 (Supp. 1988).

16. *Id.* at 211-13.

17. IND. CODE §§ 23-4-2-28(3), -30(2) (repealed effective 1993).

18. *Id.* § 23-16-12-2(a). The effective date for the IRULPA as it applies to foreign limited partnerships seeking to transact business in Indiana is January 1, 1989. *Id.* § 23-16-12-2(d).

19. *Id.* § 23-16-12-2(f)(1). The IULPA continues to apply to existing limited partnerships that do not opt in to the IRULPA. *Id.* § 23-16-12-2(g).

20. *Id.* § 23-16-12-2(e).

21. *Id.* § 23-16-12-2(f)(2). The statute provides that if a limited partnership existing under [the IULPA] before July 1, 1988, does not file a certificate of limited partnership or a certificate of amendment with the secretary of state by July 1, 1993, and no event has occurred that, under [the IRULPA], requires the filing of a certificate of amendment, then:

(1) the limited partnership continues to exist as a limited partnership under [the IRULPA], and the failure to file a certificate with the secretary of state does not impair the validity of any contract or act of the limited partnership nor prevent the limited partnership from defending any action in any court

of the Delaware Act which also provides for an extended effective date.<sup>22</sup>

The IRULPA approach differs from the current version of the Model Act which provides that the repeal of any earlier limited partnership statute does not impair, or otherwise affect, the organization or the continued existence of an existing limited partnership, nor impair any contract or affect any right accrued before its effective date.<sup>23</sup> The purpose of this savings clause is to ensure that the application of the Model Act to existing limited partnerships "would not violate constitutional prohibitions against the impairment of contracts."<sup>24</sup>

Interestingly, the IRULPA provides that an existing limited partnership which does not file a new or amended limited partnership certificate by July 1, 1993, continues as a limited partnership under the IRULPA, and that failing to file does not impair the validity of any contract or act of the limited partnership or prevent it from defending any action in an Indiana court.<sup>25</sup> It is not clear whether this provision would affect rights accrued against the partnership or against the general or limited partners under the IULPA before July 1, 1993, which raises some possible constitutional problems. However, there probably will be few if any limited partnerships that might face such problems.

A limited partnership organized under the IRULPA may carry on any business which a general partnership may conduct except the making of insurance within the meaning of the Indiana Insurance Law.<sup>26</sup> A general partnership is defined in the Indiana Uniform Partnership Act (IUPA) as "an association of two (2) or more persons to carry on as co-owners a business for profit."<sup>27</sup> The term business is defined in the

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in Indiana;

- (2) a limited partner of the limited partnership is not liable as a general partner solely by reason of the failure to file a certificate with the secretary of state; and
- (3) the limited partnership may not maintain an action in any court of Indiana until it has filed a certificate with the secretary of state in compliance with [the IRULPA].

*Id.* § 23-16-12-2(h).

22. DEL. CODE ANN. tit. 6, § 17-114 (Supp. 1986).

23. REV. UNIF. LIMITED PARTNERSHIP ACT § 116, 6 U.L.A. 365 (Supp. 1988).

24. *Id.*

25. IND. CODE § 23-16-12-2(h) (1988). The IULPA was similar. *Id.* § 23-4-2-3 (repealed effective 1993).

26. *Id.* § 23-16-2-7. A proposed business contemplating the purchase of liquor by individuals and the entering into of storage and service agreements with various private clubs has been held to be neither a "business" nor "operated for profit" within the meaning of the ULPA. *Roby v. Day*, 635 P.2d 611 (Okla. 1981).

27. IND. CODE § 23-4-1-6 (repealed effective 1993). The existence of statutes authorizing the organization of particular types of partnerships with special attributes does not preclude the use of a limited partnership unless the special statute and the limited



IUPA to include "every trade, occupation, or profession."<sup>28</sup>

Limited partnership statutes are not the only sources of law controlling limited partnerships. Other statutes might restrict the otherwise lawful business of a limited partnership. For example, it has been held that the failure to comply with statutory requirements regulating entry into the liquor business made a limited partnership agreement void and unenforceable.<sup>29</sup> It also has been held that a statute limiting the amount of land that can be owned by a corporation or association controlled by nonresident aliens applied to a limited partnership.<sup>30</sup> A general partnership must be dissolved if its business becomes illegal after its inception<sup>31</sup> and presumably this is the case with limited partnerships as well.

### III. SUBSTANTIVE PROVISIONS OF IRULPA

#### A. Definitions and General Provisions

One of the most obvious differences between the old Act and the new Act is that the IRULPA groups related provisions in twelve separate chapters.<sup>32</sup> The IULPA substantive provisions are contained in one chapter.<sup>33</sup> This change makes it easier for an attorney to review the statutory rules that apply to limited partnerships.

The definition sections of the IRULPA are in chapter 1.<sup>34</sup> The general provisions are in chapter 2.<sup>35</sup> These include the provisions relating to names of limited partnerships.<sup>36</sup> Under IRULPA a limited partnership

partnership act are irreconcilable. *See Stowe v. Merrilees*, 6 Cal. App. 2d 217, 44 P.2d 368 (1935) (limited partnership for mining purposes proper even though special statute provided for mining partnerships).

28. IND. CODE § 23-4-1-2 (repealed effective 1993).

29. *See Sponholz v. Meyer*, 27 Wis. 288, 70 N.W.2d 619 (1955) (limited partner's accounting action dismissed because of his failure to disclose his name in the liquor license application, even though the purpose of the licensing act was to disclose those persons controlling licensee.) *Cf. Searles v. Haynes*, 126 Ind. App. 626, 129 N.E.2d 362, *reh'g denied*, 130 N.E.2d 2182 (1955).

30. *Lehndorff Geneva, Inc. v. Warren*, 74 Wis. 2d 369, 246 N.W.2d 815 (1976).

31. *See Searles*, 126 Ind. App. 626, 129 N.E.2d 362.

32. IND. CODE §§ 23-16-1 to -12 (1988). The model act has eleven articles.

33. *Id.* § 23-4-2 (repealed effective 1993).

34. *Id.* §§ 23-16-1-1 to -14. The definitions in the model act are contained in Article 3.

35. *Id.* §§ 23-16-2-1 to -9.

36. *Id.* § 23-16-2-1. The name of a limited partnership as set forth in its certificate of limited partnership must contain the words "limited partnership" or the abbreviation "L.P." *Id.* § 23-16-2-1(a)(1). It "may not contain the name of a limited partner unless: (A) it is also the name of a general partner or the corporate name of a corporate general partner; (B) or the business of the limited partnership had been carried on under the name before the admission of that limited partner." *Id.* § 23-16-2-1(a)(2). The name "may

may reserve the exclusive right to a name.<sup>37</sup> The IULPA did not provide for reservation of names of limited partnerships. Even though the records of limited partnerships will now be in the office of the Secretary of State, as with corporations, the IRULPA unlike the Model Act<sup>38</sup> and the Delaware Act<sup>39</sup> inexplicably does not integrate the registration of limited partnership names with corporation names. Thus, an Indiana limited partnership can have a name that is not distinguishable from the name of an Indiana corporation or a registered foreign corporation.<sup>40</sup>

Chapter 2 of the IRULPA requires a limited partnership to maintain in the state an office and an agent for service of process.<sup>41</sup> The IRULPA goes beyond the Model Act by providing for the resignation of registered agents<sup>42</sup> and for service of process on limited partnerships.<sup>43</sup> The IRULPA prescribes certain partnership records that must be kept in the registered office,<sup>44</sup> and gives partners the right to inspect these records.<sup>45</sup> There were no counterparts to these provisions in the IULPA. The effect of these provisions is to create a statutory scheme similar to that existing for corporations under the IBCL.

The IRULPA eliminates what was in effect a fraudulent conveyance provision applicable to secured loans by limited partners, as well as the prohibition against a general partner sharing pro rata with other partnership creditors in the case of unsecured loans.<sup>46</sup> Section 23-16-2-8<sup>47</sup> which effects this change is similar to, but goes beyond, the Model Act,<sup>48</sup> and gives the partners very extensive rights to deal with the

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not contain any word or phrase indicating or implying that it is organized other than for a purpose stated in its partnership agreement." *Id.* § 23-16-2-1(a)(3). Generally the name of a limited partnership "must be such as to distinguish it upon the records in the office of the secretary of state from the name of any limited partnership reserved, registered, or organized under the laws of Indiana or qualified to do business or registered as a foreign limited partnership in Indiana," *id.* § 23-16-2-1(a)(4), but a non-distinguishable name may be used with the consent of the other limited partnership or by a court judgment. *Id.* § 23-16-2-1(b).

37. *Id.* § 23-16-2-2.

38. REV. UNIF. LIMITED PARTNERSHIP ACT § 102(3), 6 U.L.A. 241 (Supp. 1988).

39. DEL. CODE ANN. tit. 6, § 17-102(4) (Supp. 1986).

40. This can be a significant problem in Indiana because a corporation can indicate its corporateness in its name by using the word "Limited" or the abbreviation "Ltd." It can be argued that "XYZ, Ltd.," a corporation, is distinguishable from "XYZ, L.P.," a limited partnership, but it can be questioned if that is a distinction with a difference in the real world.

41. IND. CODE § 23-16-2-3(a) (1988).

42. *Id.* § 23-16-2-4.

43. *Id.* § 23-16-2-5.

44. *Id.* § 23-16-2-6(a).

45. *Id.* § 23-16-2-6(b).

46. *Id.* § 23-4-2-13 (repealed effective 1993).

47. IND. CODE § 23-16-2-8 (1988).

48. REV. UNIF. LIMITED PARTNERSHIP ACT § 107, 6 U.L.A. 256 (Supp. 1988). This



partnership, including the right to borrow from the partnership, except as provided in the partnership agreement.

The IRULPA also goes beyond the Model Act and the IULPA by authorizing the indemnification of partners, employees, officers or agents of the limited partnership.<sup>49</sup> It is not clear to what extent this indemnification right will affect the otherwise unlimited personal liability of a general partner in a limited partnership.

Unlike a general partnership which can be a private, informal and voluntary arrangement among the partners, creating a limited partnership still requires compliance with the statutory provisions of the IRULPA.<sup>50</sup> However, the "formalities" of the IRULPA are less extensive than those of the IULPA. The IULPA statutory scheme emphasized a certificate of limited partnership which did not comport with commercial reality. In fact, the IULPA did not even expressly recognize the existence of a partnership agreement.

### *B. Formation and Certificate of Limited Partnership*

The IRULPA recognizes in chapter 3 that the basic document in a limited partnership is the partnership agreement, just as in a general partnership. Except with respect to assignments of partnership interests, "a person has the rights, and is subject to the liabilities, of a general partner only if the person has signed a limited partnership agreement in person or by an attorney-in-fact."<sup>51</sup> The IRULPA provides that an agreement may be amended from time to time. However,

unless the partnership agreement provides otherwise, an amendment of the partnership agreement may be made only with the written consent of each limited partner who may be adversely affected by an amendment that would accomplish any of the following:

- (1) Increase the obligations of any limited partner to make

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section makes substantial changes to section 13 of the IULPA. The drafters did not intend to give carte blanche to partners, but rather concluded that such matters should be controlled by general fraudulent conveyance statutes or by doctrines developed under bankruptcy or insolvency laws which may require subordination of loans by partners. REV. UNIF. LIMITED PARTNERSHIP ACT, 6 U.L.A. 256 (Supp. 1988). Presumably this will be the case in Indiana.

49. IND. CODE § 23-16-2-9 (1988). Delaware does, too. See DEL. CODE ANN. tit. 6, § 17-18 (Supp. 1986).

50. A limited partnership cannot be formed by "implication." See *MIF Securities v. R.C. Stamm & Co.*, 94 A.D.2d 211, 463 N.Y.S.2d 771 (1983). See generally CRANE & BROMBERG, *supra* note 5, § 26(b).

51. IND. CODE § 23-16-3-1(a) (1988).

contributions.

(2) Alter the allocation for tax purposes of any items of income, gain, loss, deduction, or credit.

(3) Alter the manner of computing the distributions of any partner.

(4) Alter, except as provided in [the agreement], the voting or other rights of any limited partner.

(5) Allow the obligation of a partner to make a contribution to be compromised by written consent of fewer than all partners.

[or]

(6) Alter the procedures for amendment of the partnership agreement.<sup>52</sup>

The authority for the partnership agreement "to provide otherwise," which authority is not in the Model or Delaware Acts, can jeopardize the rights of limited partners of Indiana limited partnerships.

A limited partnership is still required to file a certificate of limited partnership containing specified information<sup>53</sup> which is filed in the office of the Secretary of State.<sup>54</sup> Centralized filing of certificates of limited partnerships is a major change from the scheme of the IULPA. It should simplify greatly the task of an attorney organizing a limited partnership. The Secretary of State's office has prepared many documents for filing by corporations under the IBCL. However, the incumbent Secretary of State has elected not to provide forms for limited partnership transactions or filings.<sup>55</sup>

A limited partnership certificate must include the following:

(1) The name of the limited partnership.

(2) The address of the office and the name and address of the agent for service of process.

(3) The name and the business address of each general partner.

(4) The latest date upon which the limited partnership is to dissolve. [and]

(5) Any other matters the general partners agree to include.<sup>56</sup>

A limited partnership is formed at the time the initial certificate of limited partnership is filed in the office of the Secretary of State "or

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52. *Id.* § 23-16-3-1(b).

53. *Id.* § 23-16-3-2(a).

54. The limited partnership certificate required by the IULPA was filed with the county recorder of the county in which the principal place of business of the partnership is located. *Id.* § 23-4-2-2(b).

55. See Indiana Limited Partnership Guide § I(A)(4).

56. IND. CODE § 23-16-3-2(a) (1988).



at any later time specified in the certificate of limited partnership if, in either case, there has been substantial compliance with the requirements of the IRULPA.”<sup>57</sup> “Unless the certificate specifies an effective date that is different from the filing date, the time and date of the filing of the certificate is conclusive evidence as to when a limited partnership is formed.”<sup>58</sup>

A limited partnership was formed under the IULPA “if there had been substantial compliance in good faith with the requirements of [the act].”<sup>59</sup> Controversies could arise whether there had been such compliance if the limited partnership did business in several counties and its certificate was not filed in each county recorder’s office where the limited partnership did substantial business.<sup>60</sup> This problem was eliminated by the central filing approach of the IRULPA.

The IRULPA requires the filing of a certificate of amendment to a limited partnership certificate within sixty days after certain events,<sup>61</sup> and at any time for any other proper purpose the general partners may determine.<sup>62</sup> Filing a certificate of amendment within the sixty-day period “absolves a person from any liability that might arise because the limited partnership certificate did not reflect the occurrence of the event before the filing of the amendment.”<sup>63</sup> The IRULPA goes beyond the Model Act and the Delaware Act in this respect. The Model Act only absolves persons from liability where the amended certificate is required because a new general partner has been admitted, a general partner has withdrawn, or the partnership continues after a nonjudicial dissolution.<sup>64</sup> The IRULPA extends the protection to situations where a general partner becomes aware that a statement in the certificate was false when made or has become inaccurate. This difference can be beneficial to the interests of

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57. *Id.* § 23-16-3-2(b).

58. *Id.*

59. *Id.* § 23-4-2-2(2) (repealed effective 1993).

60. See CRANE & BROMBERG, *supra* note 5, § 26(b) at 145-46.

61. IND. CODE § 23-16-3-3(b) (1988). These include:

- (1) The admission of a new general partner.
- (2) The withdrawal of a general partner.
- (3) The continuation of the business under [IND. CODE] § 23-16-9-1 after an event of withdrawal of a general partner.
- (4) The discovery by a general partner that any statement in the certificate of limited partnership was false when made.
- (5) The discovery by a general partner that any facts or arrangements described in the certificate of limited partnership have changed, making the certificate inaccurate in any respect.

62. *Id.* § 23-16-3-3(d).

63. *Id.* § 23-16-3-3(c).

64. REV. UNIF. LIMITED PARTNERSHIP ACT § 202(e), 6 U.L.A. 265 (Supp. 1988).

the partners, and, conversely, detrimental to the interests of creditors or claimants of a limited partnership.<sup>65</sup>

The IRULPA also requires that a certificate of limited partnership be cancelled by "filing a certificate of cancellation upon the dissolution and the commencement of winding up of the partnership or at any other time there are no limited partners."<sup>66</sup> A certificate of cancellation is filed in the office of the Secretary of State.<sup>67</sup>

The old Act required all partners, including the limited partners, to sign the limited partnership certificate. The Model Act as originally drafted in 1976 continued this requirement.<sup>68</sup> The current version of the Model Act, on which the IRULPA is based, eliminated the requirement that limited partners sign the certificate. All general partners must sign the original limited partnership certificate,<sup>69</sup> and all new general partners, and at least one existing general partner if there is one, must sign a certificate of amendment or restatement of a limited partnership certificate.<sup>70</sup> All general partners must sign a cancellation certificate, but if there are no general partners, the cancellation certificate "must be signed by a majority in interest of the limited partners."<sup>71</sup> The execution of

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65. For example, it is not impossible that a limited partner could escape liability by having the certificate amended to change the name of the partnership where the limited partner knowingly permitted his or her name to be used in the name of the limited partnership, and who as a consequence would be liable to creditors who extended credit to the limited partnership thinking the limited partner was a general partner because of the "erroneous certificate," if the creditors had no actual knowledge that the person was not a general partner. Of course, a court may prevent this result by characterizing it as fraud, and it might constitute perjury if the general partners who signed the certificate knew of the deception. IND. CODE § 23-16-3-5(a)(3) (1988).

66. *Id.* § 23-16-3-4.

67. The certificate of cancellation must contain:

- (1) The name of the limited partnership.
- (2) The date of filing of its certificate of limited partnership.
- (3) The reason for filing the certificate of cancellation.
- (4) The effective date or time (which must be a date or time certain) of cancellation if it is not to be effective upon the filing of the certificate.
- (5) Any other information the person filing the certificate of cancellation determines.

*Id.*

68. REV. UNIF. LIMITED PARTNERSHIP ACT § 204 comment, 6 U.L.A. 272-73 (Supp. 1988).

69. IND. CODE § 23-16-3-5(a)(1) (1988). A person may sign a limited partnership certificate, a limited partnership agreement or an amendment to a certificate or agreement by an attorney-in-fact. *Id.* § 23-16-3-5(b). The Delaware Act also permits this, DEL. CODE ANN. tit. 6, § 17-204(b), but the Model Act limits this right to the execution of certificates. REV. UNIF. LIMITED PARTNERSHIP ACT § 204(b), 6 U.L.A. 272 (Supp. 1988).

70. IND. CODE § 23-16-3-5(a)(2) (1988).

71. *Id.* § 23-16-3-5(a)(3).



a certificate constitutes an "oath or affirmation under the penalties of perjury that to the best of the [signer's] knowledge and belief the statements made in the certificate are true."<sup>72</sup> Any person adversely affected by the failure of a person required to execute a certificate to do so may petition the appropriate circuit or superior court for an order directing the Secretary of State to file a certificate.<sup>73</sup>

It is no longer necessary for a person executing a certificate as an agent or fiduciary to exhibit evidence of authority as a prerequisite to filing the certificate with the Secretary of State.<sup>74</sup> A certificate is filed unless the Secretary of State finds that it does not conform to law.<sup>75</sup> The fact that a certificate of limited partnership is on file in the office of the Secretary of State is notice that the partnership is a limited partnership and is notice of all other facts that are required to be set forth in a limited partnership certificate under the IRULPA and that are thus set forth in the certificate.<sup>76</sup>

The Model Act contains explicit statutory recognition of the practice of restating an amended limited partnership certificate.<sup>77</sup> However, the Model Act provision is not nearly as detailed as the IRULPA,<sup>78</sup> which is patterned on the Delaware Act.<sup>79</sup>

Unlike the old Act, the IRULPA does not require disclosure of the limited partners' capital contributions and their participation in the profits of the enterprise. This increases the desirability of the limited partnership as a business form where the participants wish to keep confidential the amount of their investments.

The IRULPA also does not require publication or notification other than the required filing to form a limited partnership.<sup>80</sup> Unlike the old Act, the new Act does require the name of a limited partnership to include words indicating its nature,<sup>81</sup> which is the most effective manner

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72. *Id.* § 23-16-3-5(c). The Model Act provides that the execution of a certificate constitutes an affirmation under the penalties of perjury that the facts are true and not merely true to the best of the person's knowledge and belief. REV. UNIF. LIMITED PARTNERSHIP ACT § 204(c), 6 U.L.A. 272 (Supp. 1988).

73. IND. CODE § 23-16-3-6 (1988).

74. *Id.* § 23-16-3-7(a).

75. *Id.* General partners are obligated to deliver a copy of the filed limited partnership certificate to the limited partners unless the limited partnership agreement provides otherwise. *Id.* § 23-16-3-1.

76. *Id.* § 23-16-3-9.

77. REV. UNIF. LIMITED PARTNERSHIP ACT § 2027(f), 6 U.L.A. 265 (Supp. 1988).

78. IND. CODE § 23-16-3-11 (1988).

79. DEL. CODE ANN. tit. 6, § 17-210 (Supp. 1986).

80. The organizers of a limited partnership, however, must comply with the Indiana Assumed Business Names Act, IND. CODE §§ 23-15-1-1 to -4 (1988), which requires the filing of certificates in the office of the county recorder of each county where the partnership has an office or a place of business.

81. IND. CODE § 23-16-2-1(a)(1) (1988).

of communicating the status of the firm to third persons. As previously noted, the IRULPA prohibits the name of a limited partner from appearing in the partnership name unless it is also the name of a general partner, or the corporate name of a corporate general partner,<sup>82</sup> or the business had been carried on under a name containing the name before the limited partner was admitted.<sup>83</sup> The IULPA expressly provided that a limited partner whose name appeared in the partnership name was liable as a general partner to creditors who extended credit to the partnership without actual knowledge that the person was not a general partner.<sup>84</sup>

At one time, there was some question whether a corporation could be a partner, either general or limited.<sup>85</sup> However, a corporation can be a partner under the IBCL,<sup>86</sup> and could be under the predecessor Indiana General Corporation Act.<sup>87</sup> The fact that a corporation can be the general partner in a limited partnership can defeat the assumption that a limited partnership will have a solvent general partner with unlimited liability. A corporate general partner is liable only to the extent of its assets, unless circumstances exist where a court may be willing to disregard the corporate fiction or "pierce the corporate veil" and hold the shareholders personally liable.<sup>88</sup> Of course, there is no assurance that an individual who is a general partner is and always will be solvent.

The various limited partnership statutes do not restrict the number of general or limited partners and there are many large publicly-held limited partnerships. Limited partnership interests can be considered securities and the public sale of such interests may require compliance with both federal<sup>89</sup> and state securities laws.<sup>90</sup>

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82. *Id.* § 23-16-2-1(a)(2)(A).

83. *Id.* § 23-16-2-1(a)(2)(B).

84. IND. CODE § 23-4-2-5(2) (repealed effective 1993).

85. *See, e.g.,* Mallory v. Hanover Oil Works, 86 Tenn. 598, 8 S.W. 396 (1888); Whittenton Mills v. Upton, 76 Mass. (10 Gray) 582 (1858). *See generally* Note, *The Corporation as Managing Partner in a Limited Partnership*, 55 N.D.L. REV. 271 (1979).

86. IND. CODE § 23-1-22-2(9) (1984). The partnership business must be within the scope of the corporation's articles. Lurie v. Arizona Fertilizer & Chem. Co., 11 Ariz. 482, 421 P.2d 330 (1966).

87. IND. CODE § 23-1-2-2(a)(14) (repealed 1987). Before the IGCA was amended, a corporation could be a partner if the power was granted in the articles of incorporation.

88. *Compare* Delaney v. Fidelity Lease Ltd, 526 S.W.2d 543 (Tex. 1975), with *Frigidaire Sales Corp. v. Union Properties, Inc.*, 14 Wash. App. 634, 544 P.2d 781 (1975), *aff'd*, 88 Wash. 2d 400, 562 P.2d 244 (1977).

89. *See, e.g.,* SEC v. Murphy, 626 F.2d 633, 640-41 (9th Cir. 198); *Beatty v. Basic Resources Int'l, SA*, 1985-86 Fed. Sec. L. Rptr (CCH) ¶ 92,452 (S.D.N.Y. 1986). *See also* *Rode v. Gillman*, 1985-86 Fed. Sec. L. Rptr. (CCH) ¶ 92,547 (7th Cir. 1986) (limited partnership interest a security despite option to buy-out general partners).

90. *See, e.g.,* Garbo v. Hilleary Franchise Sys., Inc., 479 S.W.2d 491 (Mo. Ct. App. 1972).



Section 207<sup>91</sup> of the Model Act both expands and narrows liability for false statements in the certificate of limited partnership over the comparable provision in the predecessor Uniform Limited Partnership Act.<sup>92</sup> The IRULPA is less expansive than the Model Act. It does provide explicitly that a person who signs a certificate as an agent under a power of attorney, as well as those for whom the agent signs who knew a statement was false at the time the certificate was executed, is liable to persons who are damaged by reasonable reliance on a false statement.<sup>93</sup> The new Act does extend potential liability for false statements to general partners who should have known of the false statement as well as those who knew the statement was false,<sup>94</sup> and to any general partner who:

after the execution of [a limited partnership certificate], but at least sixty (60) days before the statement was reasonably relied upon, knew or should have known that any arrangement or other fact described in a statement in the certificate had changed, . . . and failed to cancel or amend the certificate or to file a petition for the cancellation or amendment of the certificate under section [23-16-3-6 of the IRULPA] before the statement was reasonably relied upon.<sup>95</sup>

Again, however, the liability is limited to those who suffered loss by reasonable reliance on the false statement.<sup>96</sup>

As stated earlier, the IRULPA gives general partners an escape clause from liability for false statements in certificates.

A general partner is not liable for failing to cancel or amend a certificate or for failing to file a petition for the amendment or cancellation of a certificate under [section 23-16-3-8(a)(2)] if a certificate of amendment, certificate of cancellation, or petition for amendment or cancellation is filed within sixty (60) days after the general partner knew or should have known to the

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91. See REV. UNIF. LIMITED PARTNERSHIP ACT § 207, 6 U.L.A. 281 (Supp. 1988).

92. See *id.* § 207 comment, 6 U.L.A. 281.

93. IND. CODE § 23-16-3-8(a)(1) (1988). The Model Act does not contain a requirement that the reliance be "reasonable." The Delaware Act does. DEL. CODE ANN. tit. 6, § 17-27(a) (Supp. 1988). This approach reduces, at least in theory, the universe of potential plaintiffs by eliminating those who "rely" but whose reliance is not "reasonable," presumably using some objective standards.

94. IND. CODE § 23-16-3-8(a)(2) (1988).

95. *Id.* § 23-16-3-8(a)(3).

96. Section 23-16-3-8 narrows potential liability for false statements by confining to general partners the obligation to amend a certificate of limited partnership where future events have made a statement in a certificate inaccurate. All partners were subject to liability under the IULPA. *Id.* § 23-4-2-6.

extent provided in section [23-16-3-8(a)] that the statement in the certificate was false in any material respect.<sup>97</sup>

Another major difference between the old and new Acts is that the IRULPA permits the merger of Indiana limited partnerships with other Indiana limited partnerships or partnerships organized under the laws of another state, with one partnership being the surviving partnership as provided by the merger agreement.<sup>98</sup> A domestic limited partnership that is not the surviving partnership must file a certificate of cancellation with an effective date not later than the effective date of the merger.<sup>99</sup> If the surviving limited partnership in a merger is a foreign limited partnership, it must attach a certificate to the Indiana limited partnership's certificate of cancellation stating that the foreign limited partnership agrees to be served with process in Indiana in any action to enforce an obligation of the nonsurviving Indiana limited partnership, that it consents to the Secretary of State as agent for service of process, and that it is providing an address to which the process may be mailed.<sup>100</sup> The IRULPA merger provision also spells out the consequences of a merger of limited partnerships with respect to such matters as continued liability for obligations, title to property, and similar rights and duties.<sup>101</sup>

### C. *Rights and Duties of Limited Partners*

The provisions relating to the rights, duties and liabilities of limited partners are contained in chapter 4 of the IRULPA. The most significant concern of a limited partner is the possibility of losing limited liability status. There are two situations where the availability of limited liability is an issue: (1) where there has been a failure to comply fully with the statutory requirements; and (2) where the limited partner has taken part in "the control of the business."

(1) *Failure to comply fully with the statutory requirements.*—One purpose of the drafters of the original Uniform Limited Partnership Act was to prevent limited partners from losing limited liability for trivial failures to comply with the statute. The Model Act continues this approach.<sup>102</sup> The IRULPA, not surprisingly, goes further. As noted, the process of forming a limited partnership has been simplified,<sup>103</sup> and a

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97. *Id.* § 23-16-3-8(b).

98. *Id.* § 23-16-3-12(a). The statute does not permit mergers with limited partnerships organized under the laws of a foreign country.

99. *Id.* § 23-16-3-12(b).

100. *Id.* § 23-16-3-12(c).

101. *Id.* § 23-16-3-12(d).

102. *See* REV. UNIF. LIMITED PARTNERSHIP ACT §§ 201, 304, 6 U.L.A. 257, 297 (Supp. 1988).

103. *See* IND. CODE § 23-16-3-2 (1988).



limited partnership is formed when there has been "substantial compliance" with the section of the statute pertaining to the limited partnership certificate,<sup>104</sup> even if the partnership does not comply with other provisions of the statute.

More importantly, the IRULPA provides a broader escape clause for limited partners facing potential unlimited liability as a result of an improperly organized limited partnership than did the IULPA.<sup>105</sup> Section 23-16-4-4 provides that

except as provided in [section 23-16-4-4(b)], a person who makes a contribution to a partnership and erroneously but in good faith believes that the person has become a limited partner in the partnership is not a general partner in the partnership, and is not bound by its obligations by reason of making the contribution, receiving distributions from the partnership, or exercising any rights of a limited partner, if, within sixty (60) days after ascertaining the mistake, that person:

- (1) . . . causes an appropriate certificate of limited partnership or a certificate of amendment to be executed and filed, [if the person wishes to be a limited partner];<sup>106</sup> or
- (2) takes such action as may be necessary to withdraw[, if a person wishes to withdraw from the partnership].<sup>107</sup>

Section 23-16-4-4(b) further reduces the likelihood of actual liability to a third party by providing that a person who contributes to a partnership erroneously believing himself or herself to be a limited partner, is liable as a general partner to any third party who transacts business with the partnership before an appropriate limited partnership certificate is filed or the person withdraws from the partnership only if the third party actually believed in good faith that the person was a general partner at the time of the transaction; acted in reasonable reliance on that belief; and extended credit to the partnership in reasonable reliance on the credit of that person.<sup>108</sup>

The prospect of liability under these circumstances is somewhat greater under the Model Act than under the IRULPA.<sup>109</sup> However, because limited partners do not have to be named in the limited partnership certificate, the only time liability under section 23-16-4-4(a) is

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104. *Id.* § 23-16-3-2(b).

105. *See id.* § 23-16-4-4.

106. *Id.* § 23-16-4-4(a)(1).

107. *Id.* § 23-16-4-4(a)(2).

108. *Id.* § 23-16-4-4(b).

109. REV. UNIF. LIMITED PARTNERSHIP ACT § 304 comment, 6 U.L.A. 297 (Supp. 1988).

likely to occur is in the rare situation where a person intending to be a limited partner is erroneously identified as a general partner in the certificate.

(2) *Participating in the control of the business.*—The *quid pro quo* for limited liability under the IRULPA is the limited partner's sacrificing the right to control the management of the firm that is inherent to partners in a general partnership. Section 23-16-4-3(a) of the Act specifically provides that a limited partner is not liable for the obligations of a limited partnership unless "(1) the limited partner is also a general partner; or, (2) the limited partner, in addition to exercising the rights and powers of a limited partner, participates in the control of the business."<sup>110</sup> The IULPA had a similar provision.<sup>111</sup> One of the problems with the Uniform Limited Partnership Act was that it was unclear exactly how much review, advisory, management selection, or veto powers a limited partner could exercise without crossing the vague line of participating in the control of the business. This uncertainty was perhaps the greatest drawback of the limited partnership form of business under the IULPA.<sup>112</sup>

Many if not most of these problems have been remedied by the "safe harbor" provisions of the IRULPA. These provisions enumerate certain activities in which a limited partner may engage without being deemed to be participating in the control of the business.<sup>113</sup> These safe harbors are not exclusive, and the possession or exercise of any other powers by a limited partner does not automatically constitute participation by that limited partner in the control of the business of the limited partnership.<sup>114</sup> Of course, a limited partner cannot knowingly permit

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110. IND. CODE § 23-16-4-3(a) (1988). However, a limited partner who participates in the control of the business is liable only to persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner. *See generally* Abrams, *Imposing Liability for "Control" Under Section 7 of the Uniform Limited Partnership Act*, 28 CASE W. RES. L. REV. 785 (1978).

111. IND. CODE § 23-4-2-7 (repealed effective 1993).

112. *See generally* CRANE & BROMBERG, *supra* note 5, § 26 at 147.

113. IND. CODE § 23-16-4-3(b) (1988). One of the most important safe harbors is section 23-16-4-3(b)(1) which permits a limited partner to be an officer, director or shareholder of a corporate general partner. This provision prevents the result reached in *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543 (Tex. 1975), where the Texas Supreme Court held that if three limited partners had taken part in the control of the business within the meaning of section 7 of the ULPA by acting as officers of the corporate general partner, then they would be liable as general partners. Not all courts reached this result. *See* *Frigidaire Sales Corp. v. Union Properties, Inc.*, 14 Wash. App. 634, 544 P.2d 781 (1975), *aff'd*, 88 Wash. 2d 400, 562 P.2d 244 (1977). *See generally* Note, *supra* note 85, at 271.

114. IND. CODE § 23-16-4-3(c) (1988).



"the partner's name to be used in the name of the limited partnership, except under circumstances permitted" by the IRULPA, without incurring liability "to creditors who extend credit to the limited partnership without actual knowledge that the limited partner is not a general partner," although this liability might be avoided by changing the name of the partnership.<sup>115</sup> In essence, the IRULPA imposes liability on a limited partner who permits a situation to exist where third parties can be misled as to the limited partner's true status, but confines that liability to those who actually have been misled.

The IRULPA contains other provisions that affect the rights, duties and liabilities of limited partners. Most of these provisions are based on the Model Act but differ to some degree in form or substance. For example, like the Model Act, the IRULPA clarifies prior law by explicitly recognizing that unanimous consent of all partners is required for admission of new limited partners unless the partnership agreement provides otherwise.<sup>116</sup> However, unlike the Model Act,<sup>117</sup> the IRULPA does not require a limited partnership to maintain a record of the date a person becomes a limited partner.

The Model Act explicitly recognizes the not uncommon practice of a limited partnership agreement granting voting rights to either all or a specified group of limited partners.<sup>118</sup> The provision permits voting on matters that go beyond those for which a specific safe harbor is provided. The comparable provision in the IRULPA goes much further in authorizing the partnership agreement to provide for classes or groups of limited partners, and in specifying the rights, powers and duties of limited partners.<sup>119</sup> In this respect, the Delaware Act was the model.<sup>120</sup> One of the most significant aspects of section 23-16-4-2 is that it permits the drafters of limited partnership agreements to provide "for the future creation, in the manner provided in the partnership agreement, of additional classes or groups of limited partners having such relative rights, powers, and duties as may from time to time be established (including rights, powers, and duties senior to existing classes and groups of limited partners),"<sup>121</sup> and, subject to section 23-16-4-3, permits the drafters to

grant to all the limited partners, to certain identified limited partners, or to a specified class or group of the limited partners

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115. *Id.* § 23-16-4-4(d).

116. *Id.* § 23-16-4-1.

117. REV. UNIF. LIMITED PARTNERSHIP ACT § 301 comment, 6 U.L.A. 255 (Supp. 1988).

118. *Id.* § 302 comment, 6 U.L.A. 255 (Supp. 1988).

119. IND. CODE § 23-16-4-2 (1988).

120. See DEL. CODE ANN. tit. 6, § 17-405 (Supp. 1988).

121. IND. CODE § 23-16-4-2(a) (1988).

the right to vote (on a per capita or other basis), separately or with all or any class or group of the limited partners or the general partners, on any matter.<sup>122</sup>

These provisions doubtlessly will reassure general partners that they can establish defenses against a possible "takeover" of an Indiana limited partnership. However, such provisions should cause concern among investors who might find themselves relegated to third class status by the creation of "senior" limited partners. Finally, section 23-16-4-5 of the IRULPA is similar in substance but differs in form from section 305 of the Model Act.<sup>123</sup> Section 23-16-4-5 changes as compared to the old Act, and restates the rights of limited partners to information about the partnership.

*D. Financing, Derivative Actions and the Rights and Duties of General Partners*

Section 23-16-6-1<sup>124</sup> of the IRULPA in conjunction with the definition of "contribution" in section 23-16-1-3,<sup>125</sup> makes it clear that contributions of services are permissible forms of contribution to a limited partnership even by limited partners. The IRULPA continues the obligation of a partner to fulfill any promised contribution, if the obligation is set out in a writing signed by the limited partner.<sup>126</sup> A partner who is unable to perform promised services because of death or disability, as well as by default, is required to pay the cash value of the services except as otherwise provided in the partnership agreement.<sup>127</sup>

Like the Model Act,<sup>128</sup> the IRULPA permits a creditor to enforce an original obligation of a partner, both limited and general, to contribute to the partnership where credit is extended in reliance on the obligation before it is compromised by the partners.<sup>129</sup> This right is limited to creditors only to the extent that in extending the credit, the creditor reasonably relied on the obligation of a partner to make the contribution.<sup>130</sup> This is a departure from the Model Act and demonstrates

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122. *Id.* § 23-16-4-2(b).

123. Compare *id.* § 23-16-3-5 with REV. UNIF. LIMITED PARTNERSHIP ACT § 305, 6 U.L.A. 300 (Supp. 1988).

124. IND. CODE § 23-16-6-1 (1988).

125. *Id.* § 23-16-1-3.

126. *Id.* § 23-16-6-2(a).

127. *Id.* § 23-16-6-2(b). This option is in addition to, and is not in lieu of, any other rights, including the right to specific performance, that the limited partnership may have against such a partner under the partnership agreement or applicable law.

128. REV. UNIF. LIMITED PARTNERSHIP ACT § 502(c), 6 U.L.A. 311-12 (Supp. 1988).

129. IND. CODE § 23-16-6-2(c) (1988).

130. *Id.*



how persons dealing with Indiana limited partnerships who do not insist on examining the partnership agreement do so at their peril. The promised contribution of a limited partner does not have to be stated in the limited partnership certificate. Moreover, the IRULPA explicitly authorizes the partnership agreement to provide for the consequences and penalties if a partner fails to make a contribution.<sup>131</sup>

The IULPA did not specifically authorize a limited partner to bring a derivative suit on behalf of the partnership. However, it was generally recognized that a limited partner could bring a derivative action on behalf of a limited partnership,<sup>132</sup> by analogizing the position of a limited partner to that of a corporate shareholder.<sup>133</sup> The IRULPA expressly authorizes a limited partner to bring a derivative action<sup>134</sup> and specifies the appropriate procedures.<sup>135</sup> A limited partner whose suit is successful can recover expenses and fees from the award, the balance of which is remitted to the limited partnership.<sup>136</sup>

The IRULPA does not provide for a "litigation committee" that can consider the propriety, or lack thereof, of pursuing a derivative action filed on behalf of a limited partnership as does the IBCL with respect to Indiana corporations.<sup>137</sup> Interestingly, the drafters of the IRULPA did provide that if the damages awarded a plaintiff in such a suit are insufficient to reimburse the plaintiff's reasonable expenses, the court can direct that part or all of the reasonable expenses be paid by the partnership.<sup>138</sup>

A limited partner is entitled to a return of the partner's contribution before any claims of general partners are paid under the IULPA.<sup>139</sup> Under the IRULPA general and limited partners rank on the same level except as otherwise provided in the partnership agreement.<sup>140</sup>

Section 23-16-6-3 of the IRULPA specifies the basis on which partners share profits and losses in the absence of a written agreement.<sup>141</sup> The

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131. *Id.* § 23-16-6-2(d).

132. *See, e.g.,* Moore v. 1600 Downing Street, Ltd., 668 P.2d 16 (Colo. Ct. App. 1983); Partnership Equities, Inc. v. Marten, 15 Mass. App. Ct. 42, 443 N.E.2d 134 (1982).

133. *See generally* Hecker, *Limited Partners' Derivative Suits Under the Revised Uniform Limited Partnership Act*, 33 VAND. L. REV. 343 (1980); Reuschlein, *Limited Partnership Derivative Suits*, 9 ST. MARY'S L.J. 443 (1978).

134. IND. CODE § 23-16-11-1 (1988).

135. There is a contemporaneous ownership requirement, *id.* § 23-16-11-2, and a limited partner must attempt to have the action initiated by a general partner or plead reasons for not making the effort. *Id.* § 23-16-11-3.

136. *See* REV. UNIF. LIMITED PARTNERSHIP ACT § 1004, 6 U.L.A. 356 (Supp. 1988).

137. IND. CODE § 23-1-32-4 (1988).

138. *Id.* § 23-16-11-4(b).

139. *Id.* § 23-4-2-23 (repealed effective 1993).

140. *Id.* § 23-16-9-4(3).

141. *Id.* § 23-16-6-3.

IRULPA differs from the Model Act which requires that the allocation be in writing to be effective.<sup>142</sup> Section 23-16-6-4 permits partners to choose to share distributions on a different basis than they share profits and losses by so providing in the partnership agreement.<sup>143</sup> The "default" provisions, if the agreement does not so provide, are "the agreed value . . . of the contributions made by each partner to the extent they have been received by the partnership and have not been returned."<sup>144</sup> Again the IRULPA differs from the Model Act which requires that the allocation of distributions be in writing.<sup>145</sup>

Chapter 5 of the IRULPA pertaining to general partners contains many provisions derived from the old Act. First, a general partner of an Indiana limited partnership has substantially the same rights and powers and is subject to all the restrictions of a partner in an ordinary general partnership.<sup>146</sup> Second, general partners manage the business of the limited partnership and are personally liable for all of the debts of the partnership to persons other than the partnership and other partners.<sup>147</sup> Third, they have the same liabilities to the partnership and other partners as partners in a general partnership, except as provided in the IRULPA or the partnership agreement.<sup>148</sup> Finally, because a corporation can be a general partner in a limited partnership, it is possible to limit the overall liability of a limited partnership enterprise.<sup>149</sup>

The Model Act expanded greatly the authority of general partners *vis a vis* the partnership and the limited partners. As initially promulgated, it continued the unwaivable requirement that all limited partners must consent in writing to the admission of an additional general partner and that the consent must specifically identify the general partner involved. However, in 1985 the relevant provision was amended to require written

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142. REV. UNIF. LIMITED PARTNERSHIP ACT § 503, 6 U.L.A. 314 (Supp. 1988). The IRULPA tracks the Delaware Act in this respect. DEL. CODE ANN. tit. 6, § 17-503 (Supp. 1986). The Model Act requirement that matters of substantial importance be in writing is to avoid fraud.

143. *Id.* § 23-16-6-4.

144. IND. CODE § 23-16-6-4 (1988).

145. REV. UNIF. LIMITED PARTNERSHIP ACT § 504, 6 U.L.A. 316 (Supp. 1988). Again the IRULPA follows the Delaware Act in this respect. DEL. CODE ANN. tit. 6 § 17-504 (Supp. 1986).

146. IND. CODE § 23-16-5-3(a) (1988).

147. *Id.* § 23-16-5-3(b). A general partner's liability to a third party does not change even if the general partner subsequently becomes a limited partner. *Hartford Fin. Serv. v. Florida Software Serv., Inc.*, 550 F. Supp. 1079 (D. Me. 1982), *appeal dismissed*, 712 F.2d 724 (1st Cir. 1983).

148. IND. CODE § 23-16-5-3(c) (1988).

149. It is also possible for a limited partnership to be the general partner of another limited partnership. *See, e.g., Radio Picture Show Partnership v. Exclusive Int'l Pictures*, 482 N.E.2d 1159 (Ind. Ct. App. 1985).



consent only if the partnership agreement does not provide in writing for the admission of additional general partners.<sup>150</sup> This language was adopted by the drafters of the IRULPA.<sup>151</sup>

Section 23-16-5-2 of the IRULPA expands the provisions of the old Act as to when a person ceases to be a general partner.<sup>152</sup> The old Act provided for dissolution of the partnership on the retirement, death or insanity of a general partner, unless the business was continued by remaining general partners under a right so stated in the limited partnership certificate or with the consent of all partners.<sup>153</sup> The IRULPA recognizes as does the Model Act, that other events can cause the dissolution of a limited partnership, albeit possibly giving rise to a breach of contract action against a general partner who dissolves it in contravention of the partnership agreement.<sup>154</sup> Section 23-16-5-2 further recognizes that limited partners should be able to replace a general partner who is in financial dire straits and that a general partner which is not a natural person, such as a corporation, can "die" just as a natural person.<sup>155</sup>

The IRULPA continues the basic approach of the IULPA that, except as provided in the Act, a general partner in a limited partnership has the same rights and powers and is subject to the same restrictions as a partner in a general partnership.<sup>156</sup> As initially adopted in 1976, the Model Act could have been read as authorizing a provision in a limited partnership agreement limiting general partners' liability to creditors of the partnership. However, the language of IRULPA sections 23-16-5-3(b) and (c), like the current version of section 403 of the Model Act, makes it clear that the partnership agreement can modify the relationship of the general partner to the partnership and other partners, but that the agreement cannot limit the liability of general partners to third persons.<sup>157</sup>

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150. REV. UNIF. LIMITED PARTNERSHIP ACT § 401, 6 U.L.A. 302 (Supp. 1988).

151. IND. CODE § 23-16-5-1 (1988).

152. *Id.* § 23-16-5-2.

153. *Id.* § 23-4-2-20 (repealed effective 1993).

154. REV. UNIF. LIMITED PARTNERSHIP ACT § 402 comment, 6 U.L.A. 304 (Supp. 1988).

155. IND. CODE § 23-16-5-2(6)-(10) (1988). For example, a corporation "dies" when it is dissolved or its articles of incorporation are revoked. Interestingly, the IRULPA is phrased in terms of a certificate of dissolution although a corporation is dissolved under the IBCL on the effective date of its articles of dissolution which generally is when they are filed with the Secretary of State. *Id.* § 23-1-45-3(b).

156. *Id.* § 23-16-5-3.

157. *Id.* § 23-16-5-3(b), (c); REV. UNIF. LIMITED PARTNERSHIP ACT § 403(b), 6 U.L.A. 306 (Supp. 1988). The ability to limit the liability of general partners would probably result in a determination that the enterprise possessed the corporate characteristic of limited liability for income tax purposes.

It is possible for a person to be both a general partner and a limited partner in a limited partnership under the IRULPA.<sup>158</sup> A general partner who is also a limited partner, in the partner's capacity as a limited partner, has the powers of and is subject to the restrictions of a limited partner except as provided in the partnership agreement.<sup>159</sup> Section 405 was added to the Model Act to clarify that the partnership agreement can specify the voting rights of both general and limited partners.<sup>160</sup> The IRULPA goes much further than the Model Act in authorizing classes and groups of general partners and their respective rights, powers and duties. The agreement can even permit the creation of additional classes and groups of general partners with rights, powers and duties senior to existing classes and groups of general partners.<sup>161</sup> It is not clear who exactly would create these classes, however.

As under the IULPA, the acts of a general partner bind the limited partnership under agency law principles if the acts are within the scope of the partnership's business.<sup>162</sup> The scope of the general partner's authority and the business of the partnership will be determined by the partnership agreement and, to a lesser degree, the limited partnership certificate.<sup>163</sup>

Also under existing law, a general partner owes a fiduciary duty to other general partners as well as to the limited partners.<sup>164</sup> It also has been held that a limited partnership has enough attributes of an entity apart from its members that a general partner can be convicted of embezzling partnership funds.<sup>165</sup> An attorney who is a general partner in a limited partnership is not automatically precluded from representing the partnership in legal proceedings.<sup>166</sup> The IRULPA should not change any of these rules.

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158. IND. CODE § 23-16-5-4 (1988). This was also possible under the IULPA. *Id.* § 23-4-2-12 (1982).

159. *Id.* § 23-16-5-4(b).

160. REV. UNIF. LIMITED PARTNERSHIP ACT § 405 comment, 6 U.L.A. 301 (Supp. 1988). However, if limited partners are entitled to vote on partnership matters, they do not have a right to vote as a separate class unless provided in the agreement. *Id.*

161. IND. CODE § 23-16-5-5(a) (1988). The IRULPA tracks the Delaware Act in this respect. DEL. CODE ANN. tit. 6, § 17-405 (Supp. 1986).

162. IND. CODE § 23-4-1-9 (repealed effective 1993). See *Mishawaka Fed. Sav. & Loan v. Brademas*, 162 Ind. App. 423, 319 N.E.2d 674 (1974).

163. The interpretation of provisions in a limited partnership agreement pertaining to the scope of a general partner's authority is subject to the general rules for interpreting powers of attorney. See *Klein v. Weiss*, 284 Md. 36, 395 A.2d 126 (1978).

164. See *JRY Corp. v. LeRoux*, 18 Mass. App. Ct. 153, 464 N.E.2d 82 (1984); *Alpert v. Haimes*, 64 Misc. 2d 608, 315 N.Y.S.2d 532 (1970).

165. *State v. Siers*, 197 Neb. 51, 248 N.W.2d 1 (1976).

166. See *Gorovitz v. Planning Bd. of Nantucket*, 394 Mass. 246, 475 N.E.2d 377 (1985).



*E. Distributions and Withdrawals*

Chapter 7 of the IRULPA, which is based on article 6 of the Model Act, made some significant changes from the prior law with respect to distributions and withdrawals from limited partnerships. The IRULPA permits interim distributions to partners before they withdraw from the partnership and before the partnership is dissolved and wound up.<sup>167</sup> A general partner can now withdraw from a limited partnership at any time by giving written notice, but is subject to suit for breach of contract if the withdrawal violates the partnership agreement.<sup>168</sup> The IRULPA permits a limited partner to withdraw at the time or upon the happening of events specified in the agreement, or on six months written notice, if the agreement does not specify in writing such time or events or specify a definite time for the dissolution and winding up of the limited partnership.<sup>169</sup> The distributive share of a withdrawing partner is fixed by the IRULPA in the absence of an agreement.<sup>170</sup> The IRULPA provides that except as provided in the partnership agreement, which does not have to be in writing as under the Model Act,<sup>171</sup> a partner has no right to demand a distribution in any form other than cash.<sup>172</sup> At the same time, it limits the amount a partner can be compelled to accept as a distribution of assets in kind, to the same proportion as the partner's share in the distributions of the partnership unless otherwise provided in the agreement.<sup>173</sup>

It is now clear that any partner of a limited partnership who is entitled to receive a distribution becomes a creditor of the limited partnership with respect to the distribution.<sup>174</sup> The extraordinary remedy contained in the IULPA, whereby a limited partner who was unsuccessful in demanding a return of his contribution could seek dissolution of the partnership,<sup>175</sup> was eliminated in the IRULPA. A partner entitled to a distribution will have to sue as an ordinary creditor.<sup>176</sup>

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167. IND. CODE § 23-16-7-1 (1988).

168. *Id.* § 23-16-7-2.

169. *Id.* § 23-16-7-3.

170. *Id.* § 23-16-7-4.

171. REV. UNIF. LIMITED PARTNERSHIP ACT § 605, 6 U.L.A. 322 (Supp. 1988).

172. IND. CODE § 23-16-7-5(a) (1988).

173. *Id.* § 23-16-7-5(b).

174. *Id.* § 23-16-7-6. A partner may not receive a distribution from a partnership where, after the distribution, all liabilities of the limited partnership, other than liabilities to partners on account of their partnership interests, exceed the fair value of the partnership assets. *Id.* § 23-16-7-7.

175. *Id.* § 23-4-2-16(4) (repealed effective 1993).

176. See REV. UNIF. LIMITED PARTNERSHIP ACT § 606 comments, 6 U.L.A. 323 (Supp. 1988).

The IRULPA creates a statute of limitations on the right of a limited partnership to recover all or part of a contribution that has been returned to a limited partner under certain circumstances.<sup>177</sup> The IULPA did not have any comparable provisions. The new Act defines the return of a partner's contribution as that portion of a distribution which "reduces the partner's share of the fair value of the net assets of the limited partnership below the agreed value (as stated in the records of the limited partnership) of the partner's contribution that has not been distributed to the partner."<sup>178</sup> The IULPA treated a partner holding money or property wrongfully returned to him as a trustee.<sup>179</sup> This provision was eliminated in the Model Act.

#### *F. Assignments*

Chapter 8 of the IRULPA, which is based on Article 7 of the Model Act,<sup>180</sup> relates to the assignment of partnership interests. A partnership interest is personal property,<sup>181</sup> and is assignable in whole or in part unless otherwise provided in the partnership agreement.<sup>182</sup> This eliminates the ambiguity in prior law whether any limitations on the right of assignment were permitted.<sup>183</sup> The IRULPA continues the rule that the assignment of a partnership interest neither dissolves the limited partnership nor makes the assignee a partner.<sup>184</sup> Rather, "the assignee [is entitled] to share in the profits and losses, to receive the distribution or distributions, and to receive the allocation of income, gain, loss, deduction, or credit or similar item to which the assignor was entitled, to the extent assigned."<sup>185</sup> A partner ceases to be a partner when all of the partner's partnership interest is assigned.<sup>186</sup>

Section 23-16-8-3 of the IRULPA authorizes a judgment creditor to seek a charging order against the interest of a debtor partner.<sup>187</sup> A judgment creditor has only the rights of an assignee.<sup>188</sup> The rights of

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177. IND. CODE § 23-16-7-8(a), (b) (1988).

178. *Id.* § 23-16-7-8(c). There was some question under the IULPA whether a distribution to a limited partner was his share of income or a return of his contributions.

179. IND. CODE § 23-4-2-17(2) (repealed effective 1993).

180. REV. UNIF. LIMITED PARTNERSHIP ACT §§ 701-705, 6 U.L.A. 325 (Supp. 1988).

181. IND. CODE § 23-16-8-1 (1988). A partner has no interest in specific limited partnership property. *Id.*

182. *Id.* § 23-16-8-2(1).

183. *Id.* § 23-4-2-19(1) (1982). See REV. UNIF. LIMITED PARTNERSHIP ACT § 702 comments, 6 U.L.A. 326 (Supp. 1988).

184. IND. CODE § 23-16-8-2(2) (1988).

185. *Id.* § 23-16-8-2(3).

186. *Id.* § 23-16-8-2(4).

187. *Id.* § 23-16-8-3.

188. *Id.*



judgment creditors under the IRULPA are similar to the rights available under the IULPA except that the new Act has eliminated provisions considered to be superfluous.<sup>189</sup>

An assignee may become a limited partner if the partnership agreement allows the assignee to become a limited partner or with the written consent of all partners.<sup>190</sup> The obligations of the assignor automatically assumed by an assignee who becomes a limited partner have been narrowed as compared to the prior uniform law.<sup>191</sup> An assignor is not released from liability to the limited partnership if the assignee becomes a limited partner, unless such liabilities are specifically assumed by the assignee.<sup>192</sup>

The IRULPA statutory rules dealing with the estate of a deceased or incompetent partner are substantially the same as they are under the IULPA.<sup>193</sup> The personal representative of a deceased limited partner becomes a limited partner for the purpose of settling the estate, and has any power the deceased limited partner had to make an assignee a substituted limited partner.<sup>194</sup> The estate of a deceased limited partner also is liable for all the limited partner's liabilities, although the specific provision of the IULPA to that effect has been eliminated.<sup>195</sup>

### *G. Dissolution*

The statutory provisions relating to the dissolution and winding up of limited partnerships and the distribution of assets are contained in chapter 9 of the IRULPA, which is based on article 8 of the Model Act.<sup>196</sup> One major difference between the old and new Acts is that under the IRULPA a limited partnership that would otherwise be dissolved upon the withdrawal of a general partner, or even all general partners,

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189. See REV. UNIF. LIMITED PARTNERSHIP ACT § 703 comment, 6 U.L.A. 327 (Supp. 1988).

190. IND. CODE § 23-16-8-4(a) (1988). The Model Act does not require that the partners' consent be in writing. REV. UNIF. LIMITED PARTNERSHIP ACT § 704(a), 6 U.L.A. 328 (Supp. 1988).

191. IND. CODE § 23-16-8-4(b) (1988).

192. *Id.* § 23-16-8-4(c). The assignor is not relieved of such obligations if the assignee becomes bound under either the Model Act, REV. UNIF. LIMITED PARTNERSHIP ACT § 704(c), 6 U.L.A. (Supp. 1988), or the Delaware Act, DEL. CODE ANN. tit. 6, § 17-704(c) (Supp. 1986).

193. IND. CODE § 23-4-2-21 (repealed effective 1993).

194. *Id.* § 23-16-8-5(a) (1988).

195. *Id.* § 23-4-2-21(2). See REV. UNIF. LIMITED PARTNERSHIP ACT § 705 comment, 6 U.L.A. 330 (Supp. 1988). The relevant IRULPA provision states: The powers of a partner that is a corporation, trust or other entity which is dissolved may be exercised by the partner's legal representation or successor. IND. CODE § 23-16-8-5(b) (Supp. 1988).

196. IND. CODE §§ 23-16-9-1 to -4 (1988). REV. UNIF. LIMITED PARTNERSHIP ACT §§ 801-804, 6 U.L.A. 331 (Supp. 1988).

may be continued, if all of the remaining partners, or a lesser percentage as provided in the partnership agreement, agree in writing within 90 days of the withdrawal and the appointment of one or more additional general partners if necessary or desired.<sup>197</sup> There are other causes of dissolution specified in the IRULPA. These include reaching the time for dissolution specified in the certificate of limited partnership;<sup>198</sup> the occurring of events specified in the partnership agreement;<sup>199</sup> "the written consent of all general partners and the affirmative vote of two-thirds in interest of each class of limited partners," subject to any "requirement in the partnership agreement requiring the approval by a greater or lesser percentage of limited partners and general partners;"<sup>200</sup> and the entry of a decree of judicial dissolution.<sup>201</sup> A partner is also authorized to seek judicial dissolution of a limited partnership by order of an appropriate court whenever it is not reasonably practical to carry on the business in conformity with the partnership agreement.<sup>202</sup>

The IRULPA contains a detailed provision regulating the winding up of partnership affairs,<sup>203</sup> and the distribution of its assets.<sup>204</sup> One of the major distinctions between the old Act and the new Act is that the IRULPA ranks general and limited partners on the same level except as otherwise provided in the partnership agreement.<sup>205</sup> A certificate of limited partnership must be cancelled when a limited partnership is dissolved.<sup>206</sup>

#### *H. Foreign Limited Partnerships and Miscellaneous Provisions*

The IULPA did not recognize expressly the existence of limited partnerships formed in other states.<sup>207</sup> The failure of the IULPA to deal with limited partnerships with multistate operations is a great weakness

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197. *Id.* § 23-16-9-1(a)(4), (b).

198. *Id.* § 23-16-9-1(a)(1).

199. *Id.* § 23-16-9-1(a)(2).

200. *Id.* § 23-16-9-1(a)(3). The Model Act requires the written consent of all partners, REV. UNIF. LIMITED PARTNERSHIP ACT § 801(3), 6 U.L.A. 331 (Supp. 1988), as does the Delaware Act, DEL. CODE ANN. tit. 6, § 17-801(2) (Supp. 1986).

201. IND. CODE § 23-16-9-1(a)(5) (1988).

202. *Id.* § 23-16-9-2.

203. *Id.* § 23-16-9-3.

204. *Id.* § 23-16-9-4. Partners who are creditors are treated equally with other creditors, except as to their partnership interests. Accrued obligations to make a distribution are given priority over other equity distributions. *Id.* § 23-16-9-4(2).

205. *Id.* § 23-16-9-4(3). Some courts have held that under the prior uniform act, the order of distribution cannot be changed by agreement. *See Pine Grove Dev. Corp. v. Dade Sav. & Loan Ass'n*, 478 So. 2d 80 (Fla. Dist. Ct. App. 1985); *Consolidated Amalgamated Dev. Ltd. v. Gup*, 428 So. 2d 750 (Fla. Dist. Ct. App. 1983).

206. IND. CODE § 23-16-3-4 (1988).

207. *See Radio Picture Show Partnership v. Exclusive Int'l Pictures*, 482 N.E.2d 1159 (Ind. Ct. App. 1985).



of that statute. One of the important advances of the IRULPA is that it clarifies the status of foreign limited partnerships.<sup>208</sup> A few states enacted procedures for recognizing foreign limited partnerships before the Model Act was promulgated,<sup>209</sup> and some courts recognized such enterprises by applying choice of law rules.<sup>210</sup>

The IRULPA expressly authorizes foreign limited partnerships to transact business in Indiana.<sup>211</sup> Foreign limited partnerships are those organized under the laws of another state or another country.<sup>212</sup> Before transacting business in Indiana, a foreign limited partnership must file an application for registration as a foreign limited partnership.<sup>213</sup> The Model Act does not define what constitutes transacting business. The IRULPA adopts the now common approach to determining when a foreign business organization can be subjected to state regulation without violating the commerce clause, by specifying activities, among others, that do not constitute transacting business.<sup>214</sup> The use of the phrase "among others" in section 23-16-10-2(b) indicates that the listing is not exclusive and the fact that a foreign limited partnership has engaged in an activity not set forth in the statute does not necessarily mean that it has to register as a foreign limited partnership.

The IRULPA provides that a foreign limited partnership may register with the Secretary of State under any name that includes the words "limited partnership" or the abbreviation "L.P." and which could be

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208. IND. CODE §§ 23-16-1-1 to -9. See generally Sell, *An Examination of Articles 3, 4 and 9 of the Revised Uniform Limited Partnership Act*, 9 ST. MARY'S L.J. 459, 471-77 (1978).

209. See, e.g., CAL. CORP. CODE § 15,700 (Deering Supp. 1974); TEX. REV. CIV. STAT. ANN. art. 6132a (Vernon 1970 & Supp. 1988).

210. See, e.g., *Cheyenne Oil Corp. v. Oil & Gas Ventures, Inc.*, 42 Del. Ch. 106, —, 204 A.2d 743, 746 (1964); *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 66,580 —, A.2d 906, 907-08, (1951); *King v. Sarria*, 69 N.Y. 24, 30-31 (1877). See also *Plaza Realty Investors v. Bailey*, 484 F. Supp. 335 (S.D.N.Y. 1979) (the United States District Court for the Southern District of New York applied Indiana law to an Indiana limited partnership in a diversity action); *Partnership Equities v. Marten*, 15 Mass. App. Ct. 42, 443 N.E.2d 134 (1982). See generally CRANE & BROMBERG, *supra* note 5, § 26 n.30.

211. IND. CODE § 23-16-1-1 (1988). This chapter of the IRULPA became effective on July 1, 1988.

212. *Id.* § 23-16-10-1(a)(1). A foreign limited partnership may not be denied registration because of any differences between the law under which it was organized and the law of Indiana. *Id.* § 23-16-10-1(a)(2). Indiana limited partnerships may merge with limited partnerships organized under the laws of other states but not other countries. *Id.* § 23-16-3-12.

213. *Id.* §§ 23-16-10-2(a), -3. The IRULPA specifies the information that must be included in the application. *Id.* §§ 23-16-10-2(a)(1) to (8). An original and a duplicate copy of the application signed and sworn to by a general partner of the foreign limited partnership under penalties of perjury is filed with the Secretary of State. *Id.*

214. *Id.* § 23-16-10-2(b)(1) to (11).

registered by an Indiana limited partnership.<sup>215</sup> A foreign limited partnership must maintain an office in Indiana, which is the equivalent of the registered office of a corporation under the IBCL, and a registered agent.<sup>216</sup> The registered agent is the foreign limited partnership's agent for service of process, although service on a registered agent is not the only means or necessarily the required means for serving a foreign limited partnership.<sup>217</sup>

A foreign limited partnership is required to correct statements in its application for registration that were false when made or where arrangements or other facts described in the application are false in any respect.<sup>218</sup> A foreign limited partnership that ceases to transact business in Indiana may cancel its registration by filing a certificate of cancellation with the Secretary of State.<sup>219</sup>

The IRULPA authorizes the Attorney General to sue to restrain a foreign limited partnership from transacting business in Indiana in violation of the statute, and to enjoin the limited partnership or any of its agents from doing business in Indiana if it has failed to register or its registration was procured on the basis of false or misleading representations.<sup>220</sup> A more effective sanction against an unregistered foreign limited partnership transacting business in Indiana is the provision denying it access to Indiana courts to maintain any action until it has registered and paid all fees and penalties for the years during which it was transacting business without having registered.<sup>221</sup> A third party, however, can maintain an action against the unregistered limited partnership and the partnership can defend actions brought against it in Indiana courts.<sup>222</sup> The failure to register in Indiana does not impair the validity of any contract or act of the foreign limited partnership,<sup>223</sup> and a limited partner of a foreign limited partnership is not liable as a general partner solely because the partnership has transacted business without registration.<sup>224</sup> A limited partner of a foreign limited partnership can be held liable for the obligations of the partnership by participating in the control of the

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215. *Id.* § 23-16-10-4(a), (b).

216. *Id.* § 23-16-10-4(c) to (f).

217. *Id.* § 23-16-10-5. The Secretary of State is the agent for the service of process for a foreign limited partnership transacting business in Indiana without registration. *Id.* § 23-16-10-2(c).

218. *Id.* § 23-16-10-6.

219. *Id.* § 23-16-10-7.

220. *Id.* § 23-16-10-9.

221. *Id.* § 23-16-10-8.

222. *Id.* § 23-16-10-8(b)(2), (3).

223. *Id.* § 23-16-10-8(b)(1).

224. *Id.* § 23-16-10-8(c).



business. The Secretary of State is the agent of such a limited partnership for purposes of serving process.<sup>225</sup>

Chapter 12 of the IRULPA contains miscellaneous provisions dealing with construction and application of the statute, such as severability and the effective dates.<sup>226</sup> These provisions are self-explanatory and should be consulted by persons contemplating a limited partnership.

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225. *Id.* §§ 23-16-10-2(c), -8(d).

226. *Id.* §§ 23-16-12-1 to -6.

# **The Indiana Motor Vehicle Protection Act Of 1988: The Real Thing for Sweetening the Lemon or Merely a Weak Artificial Sweetener?**

HAROLD GREENBERG\*

When the Indiana Motor Vehicle Protection Act<sup>1</sup> became effective on February 29, 1988, Indiana joined approximately thirty-seven other states<sup>2</sup> which had previously adopted what are popularly known as "lemon laws." The underlying reasons for such legislation is reasonably clear. For the average person, the purchase of a new car is probably the second most important and second most expensive purchase in a lifetime, surpassed only by the purchase of a home. At the other end of the transaction, manufacturers and dealers spend millions of dollars on television, radio and print advertising for the express purpose of encouraging customers to buy their automobiles. Unfortunately, almost anyone who has merely a passing acquaintance with automobile owners is aware of the existence of "the lemon," the defective automobile which seems to have been poorly designed or badly assembled during the manufacturer's holiday party and which nothing will ever make right.<sup>3</sup> It is equally true that no make of automobile is immune from

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\* Professor of Law, Indiana University School of Law—Indianapolis; A.B. Temple University, 1959; J.D. University of Pennsylvania, 1962. Professor Greenberg acknowledges with gratitude the assistance and insight of his research assistant, Deborah Wiers Vincent.

1. Pub. L. No. 150-1988, 1988 Ind. Acts 1863. Section 1 is codified at IND. CODE §§ 24-5-13-1 to -24 (1988) [hereinafter Lemon Law]. Sections 2-4, which relate to the Lemon Law's non-retroactivity, the date after which the Act's mandated disclosures would be required (July 1, 1988), and the Act's effective date (the date of passage), respectively, were not codified.

2. As of 1985, some form of lemon law had been enacted in Alaska, Arizona, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming. See Rigg, *Lemon Laws*, 18 Clearinghouse Rev. 1146, 1148 (1985); Vogel, *Squeezing Consumers: Lemon Laws, Consumer Warranties, and a Proposal for Reform*, 1985 ARIZ. ST. L.J. 589, 590 n.4. The Kentucky and North Carolina statutes are technically not lemon laws. See Rigg, *supra*, at 1148.

The number of states with lemon laws has apparently increased to forty-six. See N.Y. Times, July 2, 1988, § 1, at 48, col. 4.

3. Popular folklore suggests that one should resist buying a car which was assembled on a Monday, a Friday, or the day before or after a holiday, because these



"lemonitis," although some seem to resist it more successfully than others.<sup>4</sup>

The crux of the problem is and always has been that once the buyer has bought a lemon, the dealer or manufacturer, for any number of reasons, is either unwilling or unable to take all the steps necessary toward giving the buyer what the dealer and the manufacturer promised: a defect free, safe and reliable automobile reasonably worth its purchase price. The comments at hearings on a proposed federal Automobile and Warranty Repair Act describe the problem succinctly:

I think there is probably no subject of more not only concern but emotional concern and irritation, frustration, aggravation

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are the days of the highest employee absenteeism, thereby requiring the use of less experienced, substitute workers. Stories about empty soda pop cans and the like being found inside automobile doors are legendary. The same folklore suggests that one should resist buying a totally new model in its first year on the market because all the bugs probably have not been worked out.

4. *E.g.*, Buick (*Levinger v. General Motors Corp.*, 122 A.D.2d 419, 504 N.Y.S.2d 819 (1986)); Cadillac (*General Motors Acceptance Corp. v. Jankowitz*, 216 N.J. Super. 313, 523 A.2d 695 (1987)); Corvette (*Zoss v. Royal Chevrolet, Inc.*, 11 U.C.C. Rep. Serv. (Callaghan) 527 (Ind. Super. Ct. 1972)); Dodge (*Chrysler Motors Corp. v. Schachner*, 138 Misc. 2d 501, 525 N.Y.S.2d 127 (N.Y. Sup. Ct. 1988)); Ford (*Ventura v. Ford Motor Corp.*, 180 N.J. Super. 45, 433 A.2d 801 (1981)); Maserati (*Stuart Becker & Co. v. Steven Kessler Motor Cars, Inc.*, 135 Misc. 2d 1069, 517 N.Y.S.2d 692 (N.Y. Sup. Ct. 1987)); Pontiac (*Hibschman Pontiac, Inc. v. Batchelor*, 266 Ind. 310, 362 N.E.2d 845 (1977)); Renault (*Sepulveda v. American Motors Sales Corp.*, 137 Misc. 2d 543, 521 N.Y.S.2d 387 (N.Y. Civ. Ct. 1987)); Volvo (*Mountcastle v. Volvoville, USA, Inc.*, 130 Misc. 2d 97, 494 N.Y.S.2d 792 (N.Y. Sup. Ct. 1985)). The author recalls that while waiting in line to enter the New York City International Automobile Show some years ago, he saw circling the block a black Mercedes covered with large, yellow, paper lemons.

Massachusetts Department of Consumer Affairs and Business Regulation maintains a "lemon index." The makes or manufacturers which fared the poorest were Yugo, Alfa Romeo, Jaguar, AMC-Jeep-Renault, Peugeot, and General Motors. The best on the index were Range Rover, Sterling, Honda, Mercedes, Suzuki, and Toyota. *See* U.P.I. Wire Service, BC Cycle, Regional News, April 28, 1988 (NEXIS search, "lemon law and date aft October 1, 1987" (Oct. 5, 1988) [hereinafter NEXIS search]).

Consumers Union conducts an annual survey from which it compiles and publishes frequency of repair statistics. These statistics indicate that some makes of cars require substantially fewer repairs than others and that some cars have persistent problems with respect to particular components. *See, e.g.*, *Annual Automobile Issue*, CONSUMER REPORTS, April 1988.

In 1987 alone, the National Highway Traffic Safety Administration reported that more than eight million cars and light trucks, most built in 1986 and 1987, had been recalled by manufacturers for safety related defects ranging from problems which could cause fires or accidents to failures of airbag systems. *See* NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION, U.S. DEPT. OF TRANSP., SAFETY RELATED RECALL CAMPAIGNS FOR MOTOR VEHICLES AND MOTOR VEHICLE EQUIPMENT, INCLUDING TIRES, DOT HS 807-235 (1987).

and outrage than the question of the automobile that does not work.

When the consumer buys the car he thinks he is getting a car that will drive and that will service him. He thinks his warranty is going to mean that if anything goes wrong it will be fixed up well and promptly. The fact is that in all too many cases this does not happen and this business of having a car that is urgently needed for one's business and for urgent family matters, . . . having that car immobile in a society that is very mobile and where mobility is a characteristic and a requirement of everyday life is a matter of infinite frustration to over 1 million new car buyers every year.<sup>5</sup>

The sponsor of the bill added, in part,

The way things are set up now, it is in the manufacturer's interest to discourage warranty work because it costs the company significant amounts to do such work, and conversely it costs nothing not to do it. Thus, if a dealer has more than the "average" number of warranty jobs in a month, the company zone representative pays him a visit to find out why. If the high rate of warranty work continues, the company can refuse to reimburse part of it or can delay the reimbursement for longer than usual.

In addition, warranty work is reimbursed overall at a lower rate than non-warranty work—and at a slower rate because of the paperwork. So understandably neither dealers nor the good mechanics are any too eager to do warranty work.<sup>6</sup>

A former chairman of the Federal Trade Commission (FTC) has noted, "The automobile is far more prone to difficulties than any other consumer product. . . . At the Federal Trade Commission, automobile complaints far outnumber those for any other consumer product."<sup>7</sup> He added that in an FTC survey, "nearly 30 percent of motor vehicles purchased had some problem covered by the warranty. Compare this to 7 percent for warranted consumer products overall."<sup>8</sup>

The various state legislatures have reacted to the problem by enacting remedial legislation in the form of lemon laws. These enactments

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5. *Automobile Warranty and Repair Act: Hearings on H.R. 1005 before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce*, 96th Cong., 1st Sess. 1 (1979) (introductory remarks of Rep. James H. Scheuer, Subcommittee Chairman).

6. *Id.* at 17 (statement of Rep. Bob Eckhardt).

7. Pertschuk, *Consumer Automobile Problems*, 11 U.C.C. L.J. 145 (1978).

8. *Id.* at 146.



have been the subject of much comment, including criticism for their respective shortcomings.<sup>9</sup> Most lemon laws have a substantial number of features in common, but there are some significant differences. This Article examines the provisions of the Indiana Lemon Law with attention to whether and in what way it differs from or improves upon remedies already available in Indiana, whether the Indiana statute has dealt successfully with problems seen in other lemon laws, and whether it has created any new problems which require solution. The conclusion is that the lemon law is a good first step but that a number of problems should be addressed and resolved.

# I. THE RELATIONSHIP BETWEEN THE LEMON LAW, THE UNIFORM COMMERCIAL CODE, AND THE MAGNUSON-MOSS FEDERAL WARRANTY ACT

At the outset, it is important to note that all rights and remedies available under prior law remain available under Indiana's Lemon Law.<sup>10</sup> An aggrieved buyer may seek redress against a manufacturer

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9. See, e.g., Goldberg, *New Mexico's "Lemon Law": Consumer Protection or Consumer Frustration?*, 16 N.M.L. REV. 251, 282 (1986) [hereinafter Goldberg] (who characterizes New Mexico's law as "much ado about nothing"); Honigman, *The New "Lemon Laws": Expanding UCC Remedies*, 17 U.C.C. L.J. 116 (1984); Napoleon, *An Annotated Bibliography of "Lemon" Law and Other Related Publications*, 4 J.L. & COM. 517 (1984); Platt, *Lemon Auto Litigation in Illinois*, 73 ILL. B.J. 504 (1985); Reitz, *What You Should Know about State "Lemon Laws,"* 34 PRAC. LAW. 83 (April 1988); Rigg, *supra* note 2 (a survey of all state lemon laws); Sklaw, *The New Jersey Lemon Law: A Bad Idea Whose Time Has Come*, 9 SETON HALL LEG. J. 137 (1985); Vogel, *supra* note 2 (a comprehensive analysis of rights under the U.C.C., the Magnuson-Moss Warranty Act, and 37 state lemon laws); Note, *A Sour Note: A Look at the Minnesota Lemon Law*, 68 MINN. L. REV. 846 (1984) [hereinafter *A Sour Note*]; Note, *Lemon Laws: Putting the Squeeze on Automobile Manufacturers*, 61 WASH. U.L.Q. 1125 (1983); Note, *New Jersey's "Lemon Law," A Statute Ripe for Revision: Recent Developments and a Proposal for Reform*, 19 RUTGERS L.J. 97 (1987) [hereinafter *New Jersey's "Lemon Law"*]; Comment, *Sweetening the Fate of the "Lemon" Owner: California and Connecticut Pass Legislation Dealing with Defective New Cars*, 14 U. TOL. L. REV. 341 (1983); Comment, *Virginia's Lemon Law: The Best Treatment for Car Owner's Canker?*, 19 U. RICH. L. REV. 405 (1985) [hereinafter *Virginia's Lemon Law*].

10. IND. CODE § 24-5-13-20 (1988). Most lemon laws contain a similar provision. See Rigg, *supra* note 2, at 1160-61; Vogel, *supra* note 2, at 644. Those lemon laws which restrict the availability of other remedies if lemon law rights are asserted have been the subject of criticism. See, e.g., Goldberg, *supra* note 9, at 278-79 (a consumer who seeks to enforce the lemon law is "foreclosed" from revoking acceptance under the U.C.C., N.M. STAT. ANN. § 57-16A-5 (Supp. 1987)); Platt, *supra* note 9, at 507-08 (buyers electing to proceed under the Illinois New Car Buyer Protection Act are barred from a separate cause of action under the U.C.C., ILL. ANN. STAT. ch. 121 1/2, § 1205 (Smith-Hurd Supp. 1988)).

or dealer under the Uniform Commercial Code<sup>11</sup> and the Magnuson-Moss Warranty—Federal Trade Commission Improvement (Magnuson-Moss Act) Act,<sup>12</sup> as well as against the manufacturer under the Lemon Law. In the course of this Article, specific comparisons between each of these statutes are made. The following is a general summary of the relief available under each of them.

### A. *The Lemon Law*

The Indiana Lemon Law provides that if a motor vehicle suffers from a nonconformity and the buyer reports the nonconformity to the manufacturer or its authorized dealer within the earlier of eighteen months of the original delivery to a buyer or 18,000 miles of driving, the manufacturer must correct the nonconformity.<sup>13</sup> The statute says nothing about whether the manufacturer or dealer may charge even a nominal amount for the repairs, but it is presumed that the repairs must be without charge.<sup>14</sup>

A nonconformity is any defect or condition, or combination thereof, which substantially impairs the use, market value, or safety of the automobile or which fails to conform to the manufacturer's warranty. If, after a reasonable number of attempts to make the necessary corrections, the manufacturer is unable (or unwilling) to do so, the manufacturer must tender either a full refund or provide a replacement of comparable value, the choice of refund or replacement to be made by the buyer.<sup>15</sup> If the manufacturer fails to do so, the buyer must first pursue any non-binding informal dispute resolution procedure, if there is one, which has been certified by the state attorney general.<sup>16</sup> If there has been no certification or if the buyer is dissatisfied with

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11. IND. CODE §§ 26-1-2-201 to -2-725 (1988). Hereafter, references to the Uniform Commercial Code ("Code" or "U.C.C.") will be to the generic section numbers, e.g., § 2-608, rather than to the Indiana citation, e.g., § 26-1-2-608, unless the Indiana version of the U.C.C. differs from the 1978 Official Draft.

12. Pub. L. No. 93-637, 88 Stat. 2183 (1974) (codified at 15 U.S.C. §§ 2301 - 2310 (1982)).

13. IND. CODE § 24-5-13-8 (1988).

14. Cf. *State v. Ford Motor Co.*, 136 A.D.2d 154, 526 N.Y.S.2d 637 (1988); *Breasett v. Sayville Ford*, 129 Misc. 2d 1090, 495 N.Y.S.2d 626 (N.Y. Dist. Ct. 1985). In both cases, the respective courts held that a \$100 charge imposed by Ford for warranty service between 12,000 and 18,000 miles was contrary to the New York lemon law provision that any nonconformity appearing during the first 18,000 miles was to be corrected "at no charge to the consumer." N.Y. GEN. BUS. LAW § 198-a(b) (McKinney 1988). In *State v. Ford Motor Co.*, the court enjoined Ford from imposing the charge and directed that restitution be made.

15. IND. CODE §§ 24-5-13-6 to -10 (1988).

16. *Id.* § 24-5-13-19.



the informal result, the buyer may file a lawsuit to enforce his rights. If successful in the lawsuit, the buyer is entitled to recover the costs of litigation, as well as reasonable attorney's fees.<sup>17</sup>

The ultimate effect of the lemon law is to create a new, legislatively mandated, eighteen month/18,000 mile warranty against defects which substantially impair the use, value, or safety of automobiles.

### *B. The Uniform Commercial Code*

But for the recovery of attorney's fees and the specific 18-month or 18,000 mile duration of lemon law applicability, similar relief is available under the Uniform Commercial Code. In most instances, the buyer does not realize that he has bought a lemon until after he has accepted it, thereby precluding rejection under the Code.<sup>18</sup> The buyer's only Code remedies are either: (1) to revoke his acceptance because of defects which substantially impair the value of the car, return the car to the seller, and recover the amount paid plus appropriate damages;<sup>19</sup> or (2) to keep the car and seek damages for breach of warranty.<sup>20</sup>

The difficulty with either of these Code remedies is two-fold. First, as expressly permitted by the Code, the dealer's contract of sale almost always disclaims all warranties,<sup>21</sup> thereby eliminating any basis for the buyer to claim a breach by the dealer if only the U.C.C. applies.<sup>22</sup>

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17. *Id.* § 24-5-13-22.

18. *See* U.C.C. §§ 2-606, 2-607(2).

19. *See id.* §§ 2-608, 2-711.

20. *See id.* § 2-714.

21. *See id.* § 2-316.

22. *See* *Crume v. Ford Motor Co.*, 60 Or. App. 224, 653 P.2d 564 (1982). The printed purchase agreement used by an Indianapolis area Acura dealer states the following on the front, in a box to be signed by the buyer:

NO WARRANTIES - AS IS  
SOLD AS IS WITH ALL FAULTS. I HEREBY PURCHASE KNOWINGLY  
WITHOUT ANY WARRANTIES, EXPRESS OR IMPLIED WHATSOEVER,  
BY DEALER. SEE SECTION IV ON REVERSE SIDE. AGREED

*[Buyer's signature]*

Section IV on the reverse side of the agreement states:

The vehicle described on front is sold "AS IS, WHERE IS." There are no warranties expressed or implied, including any implied warranty of merchantability or fitness for a particular purpose, and no obligations or liability on the part of the Dealer. The Dealer neither assumes nor authorizes any other person to assume for it any other liability in connection with such motor vehicle or chassis. There are no warranties, expressed or implied which extend beyond the description on the face hereof.

The printed form used by an Indianapolis area Pontiac-GMC-Mazda-Isuzu dealer is almost identical, even to printing the disclaimer of warranties in section IV. The forms themselves were printed by different suppliers.

Second, manufacturers in their warranty booklets disclaim or limit all warranties other than those expressly stated, limit the buyer's remedies exclusively to repair or replacement of defective parts, and limit or preclude recovery of consequential damages, all of which is also expressly authorized by the Code.<sup>23</sup> The limitation exclusively to repair or replacement is effective unless the limitation "fails of its essential purpose,"<sup>24</sup> an occurrence usually manifested by the dealer or manufacturer's inability or unwillingness to remedy the lemon's defects within a reasonable time.<sup>25</sup> The elements of substantial impairment for purposes of revocation of acceptance and of failure of essential purpose with respect to limited remedies are undefined by the Code and are left for judicial interpretation.

Furthermore, even if the limitation of remedies fails of its essential purpose, disclaimers or modifications of warranties may remain effective so long as the proper steps to disclaim or modify were followed initially.<sup>26</sup> Thus, there will likely be no cause of action against the dealer under the Code alone.<sup>27</sup>

Because Indiana requires privity of contract between a manufacturer and a buyer in order for a buyer to recover from a remote manufacturer for economic loss caused by breach of an implied warranty, and there usually is no privity between them despite the manufacturer's express

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23. See U.C.C. §§ 2-316, 2-719. But see the discussion of the effect of the Magnuson-Moss Act on the ability to disclaim implied warranties *infra* notes 31-42 and accompanying text. See also *infra* note 79.

24. See U.C.C. § 2-719(2).

25. See, e.g., *Riley v. Ford Motor Co.*, 442 F.2d 670 (5th Cir. 1971); *Roberts v. Morgensen Motors*, 135 Ariz. 162, 659 P.2d 1307 (Ariz. Ct. App. 1982); *Olmstead v. General Motors Corp.*, 500 A.2d 615 (Del. Super. Ct. 1985).

26. See *Hahn v. Ford Motor Co.*, 434 N.E.2d 943 (Ind. Ct. App. 1982); U.C.C. § 2-316 comment 2 (1978); J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 12-12 (3d ed. 1988) [hereinafter "WHITE & SUMMERS"]. The comment states, in part:

This Article treats the limitation or avoidance of consequential damages as a matter of limiting remedies for breach, separate from the matter of creation of liability under a warranty. If no warranty exists, there is of course no problem of limiting remedies for breach of warranty. Under subsection (4) the question of limitation of remedy is governed by the sections referred to rather than by this section.

U.C.C. § 2-316 comment 2.

27. But see *General Motors Acceptance Corp. v. Jankowitz*, 216 N.J. Super. 313, 523 A.2d 695 (1987), in which the court held that by its action in transmitting the manufacturer's warranty to the buyer and in acting as the manufacturer's representative for making repairs to the buyer's car under that warranty, the dealer adopted that warranty. Further, because the Magnuson-Moss Act precludes disclaimers of implied warranties when a written warranty is given, the dealer also made an implied warranty of merchantability to the buyer.



warranty,<sup>28</sup> the buyer's recovery against the manufacturer under the Code is effectively limited to a claim of breach of the express warranty set forth in the warranty booklet. Moreover, if the matter must be litigated, the Code does not authorize an award of attorney's fees to a successful buyer unless the action was based on fraud or material misrepresentation.<sup>29</sup> Although punitive damages may be available in some situations,<sup>30</sup> automobile warranty litigation solely under the Code remains difficult, costly, and usually economically impractical in view of the time involved as compared with the probable amount of recovery.

### C. *The Magnuson-Moss Act*

One of the major reasons Congress enacted the Magnuson-Moss Act in 1975 was the difficulty and expense encountered by automobile buyers who sought to obtain redress from manufacturers for loss of bargain as a result of defects which the manufacturers were unwilling or unable to remedy.<sup>31</sup> The Act established a minimum federal warranty, called a "full warranty," and something less than the minimum federal warranty, called a "limited warranty."<sup>32</sup>

A warrantor, whether manufacturer or dealer, who gives a full warranty and is unable to remedy a defect after a reasonable number of attempts must replace the product or tender a refund of the purchase

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28. See, e.g., *Prairie Prod., Inc. v. Agchem Div.-Pennwalt, Corp.*, 514 N.E.2d 1299 (Ind. Ct. App. 1987); Greenberg, *Vertical Privity and Damages for Breach of Implied Warranty under the U.C.C.: It's Time for Indiana to Abandon the Citadel*, 21 IND. L. REV. 23 (1988).

29. See IND. CODE § 26-1-2-721 (1988). The section states in full: Remedies for material misrepresentation or fraud include all remedies available under [IND. CODE §§ 26-1-2-101 to -275 (1988)] for non-fraudulent breach. *In all suits based on fraud or material misrepresentation, if the plaintiff recovers judgment in any amount, he shall also be entitled to recover reasonable attorney fees which shall be entered by the court trying the suit as part of the judgment in that suit.* Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy.

(emphasis added) (The emphasized language, which was enacted by Act of April 21, 1975, Pub. L. No. 275, 1975 Ind. Acts 1523, constitutes an addition to the official text of U.C.C. § 2-721 which is unique to Indiana).

30. See, e.g., *Bud Wolf Chevrolet, Inc. v. Robertson*, 519 N.E.2d 135 (Ind. 1988) (truck which had been wrecked while on dealer's lot was sold as a "new" truck); *Hibschman Pontiac, Inc. v. Batchelor*, 266 Ind. 310, 362 N.E.2d 845 (1977) (dealer concealed fact that repairs had not been made and told buyer to leave and not come back; car out of service forty-five days).

31. See H.R. REP. NO. 1107, 93d Cong., 2d Sess. 6, *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 7702, 7708-09.

32. 15 U.S.C. § 2303(a) (1982).

price.<sup>33</sup> This is the Act's "lemon" provision. A warrantor who gives a limited warranty is not bound by the lemon provision, but the buyer may resort to any appropriate remedy under state law, which includes U.C.C. remedies.<sup>34</sup> The Act also provides that no warrantor, whether he gives a full or a limited warranty, may disclaim any implied warranties, including the implied warranty of merchantability; however, the giver of a limited warranty may limit the duration of implied warranties to the duration of the written warranty and may limit remedies to repair or replacement of defective parts. The giver of a full warranty may not limit the duration of implied warranties.<sup>35</sup>

The Magnuson-Moss Act has also eliminated the privity requirement, at least as to the giver of the written warranty as defined therein,<sup>36</sup> and authorizes suit directly against the warrantor, which includes a manufacturer who gives a written warranty,<sup>37</sup> but only after the buyer has proceeded through an alternative dispute resolution proceeding for defect claims if one has been established by the warrantor.<sup>38</sup> It also authorizes an award of attorney's fees to a victorious buyer, whether the buyer recovers for breach of Magnuson-Moss warranty or for an implied warranty under state law.<sup>39</sup>

The Magnuson-Moss Act has had little effect on the problems of lemon buyers because only one automobile manufacturer ever extended

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33. *Id.* § 2304(a)(4).

34. *See id.* §§ 2308, 2311(b).

35. *See id.* § 2308.

36. *Id.* § 2301(6) provides:

The term "written warranty" means—

(A) any written affirmation of fact or written promise made in connection with the sale of a consumer product by a supplier to a buyer which *relates to the nature of the material or workmanship* and affirms or promises that such material workmanship is defect free or will meet a specified level of performance over a specified period of time, or

(B) any undertaking in writing in connection with the sale by a supplier of a consumer product to refund, repair, replace, or take other remedial action with respect to such product in the event that such product fails to meet the specifications set forth in the undertaking, which written affirmation, promise, or undertaking becomes part of the basis of the bargain between a supplier and a buyer for purposes other than resale of such product.

(emphasis added).

Although similar to the express warranty of U.C.C. § 2-313, the Magnuson-Moss written warranty is not identical. *See Skelton v. General Motors Corp.*, 660 F.2d 311 (7th Cir.), *cert. denied*, 456 U.S. 974 (1982) (transmission substitution litigation). Therefore, a U.C.C. express warranty is not necessarily a Magnuson-Moss written warranty. *Id.*

37. *See* 15 U.S.C. § 2301(5) (1982), which defines "warrantor" as "any supplier or other person who gives or offers to give a written warranty or who is or may be obligated under an implied warranty.

38. *See id.* § 2310(a)(3).

39. *See id.* § 2310(d).



a full warranty to its purchasers, and that manufacturer, American Motors, no longer exists.<sup>40</sup> All other manufacturers have given only limited warranties. Because of dissatisfaction with the effectiveness of Magnuson-Moss, a Federal Automobile Warranty and Repair Act, which would have required all automobile manufacturers to give full Magnuson-Moss warranties, was introduced in 1979 but was never enacted.<sup>41</sup> It is against this legislative background that the states began to enact lemon laws in 1982.<sup>42</sup>

## II. THE PROVISIONS OF THE INDIANA LEMON LAW

### A. Applicability

Indiana Lemon Law protection extends only to automobiles and small trucks<sup>43</sup> which are "sold, leased, transferred, or replaced" by a dealer in Indiana *and* registered in Indiana after February 29, 1988.<sup>44</sup>

40. See C. REITZ, *CONSUMER PRODUCT WARRANTIES UNDER FEDERAL AND STATE LAWS* § 14.01 (2d ed. 1987).

41. See H.R. 1005, 96th Cong., 1st Sess. (1979); *Automobile Warranty and Repair Act: Hearings before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce*, 96th Cong., 1st Sess. 1-3, 15-19 (1979) (opening remarks of Rep. James H. Scheuer, Subcommittee Chairman, and statement of Hon. Bob Eckhardt, sponsor of H.R. 1005, respectively). The remarks of Representatives Scheuer and Eckhardt are quoted, in part, *supra* notes 5-6 and accompanying text.

42. The first lemon laws were enacted in California and Connecticut. See Act approved July 7, 1982, ch. 388, 1982 Cal. Stat. 1720; An Act Concerning Automobile Warranties, 1982 Conn. Acts 667 (Reg. Sess.).

43. The definition of "motor vehicle" is  
Any self-propelled vehicle that:

(1) has a declared gross weight of less than ten thousand (10,000) pounds; . . .  
(3) is intended primarily for use and operation on public highways; and  
(4) is required to be registered or licensed before use or operation.

The term does not include conversion vans, motor homes, farm tractors, and other machines used in the actual production, harvesting, and care of farm products, road building equipment, truck tractors, road tractors, motorcycles, mopeds, snowmobiles, or vehicles designed primarily for off-road use.

IND. CODE § 24-5-13-5 (1988).

44. "This chapter applies to all motor vehicles that are sold, leased, transferred, or replaced by a dealer or manufacturer in Indiana." *Id.* § 24-5-13-1.

"As used in this chapter, 'motor vehicle' or 'vehicle' means any self-propelled vehicle that: . . . (2) is sold to a buyer in Indiana and registered in Indiana; . . ." *Id.* § 24-5-13-5.

"This Act does not apply to sales, leases, transfers, or replacements made before the effective date of this act." Indiana Motor Vehicle Protection Act, Pub. L. No. 150-1988, § 2, 1988 Ind. Acts 1863, 1868.

Other lemon laws impose similar requirements.<sup>45</sup> The lemon law's "term of protection" begins "on the date of original delivery . . . to a buyer" and ends either after eighteen months or after the car has been driven a total of 18,000 miles from that delivery date, whichever occurs earlier.<sup>46</sup> Unlike lemon laws in other states, Indiana's lemon law is not expressly limited to new automobiles.<sup>47</sup> It is reasonable to assume, therefore, that it includes used cars as well, thereby giving some protection to the buyer of the low-mileage used car, at least until the eighteen-month/ 18,000-mile term of protection has expired. In essence, a lemon is a lemon is a lemon, regardless of who owns it.<sup>48</sup>

As applied to new cars, the law is clear; only new cars delivered to buyers after February 29, 1988, are within the protection of the lemon law. Application to used cars is less clear. The statute provides only that it "does not apply to sales, leases, transfers, or replacements made before" its effective date.<sup>49</sup> Consider the following problem: a car is sold new to the original buyer in January 1988, but resold by that buyer to another buyer six months later, when the car has only 7,000 miles on its odometer. Had the new car buyer delayed purchasing the automobile until February 29, the car would have been covered by the lemon law from the date of delivery. Based on the statutory language, while the car remained in the hands of the original January buyer, the lemon law did not apply. But it is possible to argue that the lemon law applied when the car was resold. The sale by the original buyer to the car's second owner occurred after the effective date,

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45. See, e.g., CONN. GEN. STAT. § 42-179(a) (Supp. 1988) ("sold or leased in this state"); DEL. CODE ANN. tit. 6, § 5001(5) (Supp. 1986) ("registered"); FLA. STAT. ANN. § 681.102(10) (West 1988) ("sold in this state"); MD. COM. LAW CODE ANN. § 14-1501(c) (Supp. 1988) ("registered in this state"); MICH. COMP. LAWS ANN. § 257.1401(e) (West Supp. 1988) ("purchased in this state"). But see MASS. GEN. LAWS ANN. ch. 90, § 7N-1/2(1) (West. Supp. 1988) (merely requires that the vehicle be sold after the law's effective date).

46. IND. CODE § 24-5-13-7 (1988). The period of coverage in other states varies but most have been for twelve months or 12,000 miles, whichever is earlier. See, e.g., ALASKA STAT. § 45.45.305 (1986); ARIZ. REV. STAT. ANN. § 44-1262 (1987); COLO. REV. STAT. § 42-12-102 (1984) (earlier of term of express warranty or one year); CONN. GEN. STAT. § 42-179(b) (Supp. 1987) (earlier of two years or 18,000 miles).

47. See, e.g., CAL. CIVIL CODE § 1793.2(e)(1), (4)(B) (West Supp. 1985); CONN. GEN. STAT. § 42-179(b) (Supp. 1987); MICH. COMP. LAWS ANN. § 257.1401 (West Supp. 1988); N.Y. GEN. BUS. LAW § 198-a(b) (McKinney 1988); PA. STAT. ANN. tit. 73, § 1952 (Purdon Supp. 1988). In her extensive review of thirty-five state lemon laws, Margaret Rigg observed that lemon laws apply only to new vehicles, except that in Minnesota and Michigan, they also apply to vehicles returned under the applicable lemon law. Rigg, *supra* note 2, at 1148.

48. With apologies to Gertrude Stein.

49. Indiana Motor Vehicle Protection Act, Pub. L. No. 150-1988, § 2, 1988 Ind. Acts 1863, 1868.



thereby placing the car within the term of protection for approximately another twelve months or 11,000 miles. This problem is caused by the failure of the statute to state that its coverage extends only to cars sold to the *original* buyer after its effective date, which appears to be what was intended. A court could interpret the lemon law as applying only to cars delivered "new" after February 29, but it is not compelled to do so. The problem will solve itself at the end of August 1989, eighteen months after the effective date. Until then, the problem remains.

The requirement of registration in Indiana seems to be aimed at the car which, although owned by an Indiana resident, is registered elsewhere as a means of avoiding the Indiana automobile excise tax. The reason for the requirement that the sale take place in Indiana is less certain. The resident of a border community who, for whatever reason, purchases a car in Kentucky, Ohio, Illinois, or Michigan receives no benefit from the lemon law as it now stands, despite being a resident of Indiana, having registered the car in Indiana, and having paid the Indiana automobile excise tax.

Similarly unprotected by the lemon law is the new resident of Indiana who moves into this state and registers a car which is perhaps only three or four months old and has been driven only a few thousand miles. Because the car was not sold to the buyer in Indiana, the Indiana Lemon Law affords that person no protection. And if the lemon law of the state where she purchased the automobile also has a registration provision similar to Indiana's, the buyer loses the protection of that state's law by moving to Indiana and registering the automobile in Indiana, as the law requires. Also, an Indiana resident who is originally protected by the lemon law loses Indiana's protection by moving to another state and registering there.

In today's mobile society, there seems to be no reason to impose what is, in effect, a burden on the interstate relocation of automobile buyers and to give manufacturers a windfall as a consequence of that mobility. Manufacturers and importers do business in all of the states. The underlying purposes of lemon laws—to give buyers safe and dependable automobiles and to induce manufacturers to improve the quality of their products and service—would be better served if the lemon law required only registration in Indiana. The manufacturer would still have the opportunity to remedy any nonconformity, and the state resident would be protected regardless of where the car was purchased.

The protected Indiana "buyer" is "any person who, for purposes other than resale or sublease, enters into an agreement or contract within Indiana for the transfer, lease, or purchase" of a covered

automobile.<sup>50</sup> This includes one-car drivers as well as fleet operators, consumers as well as commercial users. It also appears to include companies engaged in automobile rental or leasing, because only purchases for "resale or sublease" are excluded.<sup>51</sup> Such companies do not "sublease" their vehicles. A "sublease" is a new lease between one who is already a lessee of the automobile and a stranger to the original lease, which is completely different from the usual automobile lease transaction.<sup>52</sup> By expressly including a lessee within the definition of buyer, the Lemon Law has acknowledged that a long-term automobile lessee is in the same position as a true buyer with respect to whether or not the car is a lemon—he is the one who must patiently await action by the dealer or manufacturer to remedy problems.<sup>53</sup>

An ambiguity in the statute is the meaning of the word "sold" in the requirement that the vehicle be "sold to a buyer in Indiana."<sup>54</sup> The word "sold" is not defined. As noted earlier, "buyer" includes a lessee,<sup>55</sup> but "sold" does not necessarily include "leased." It could be argued, therefore, that if a leasing company doing business in Indiana purchases its automobiles directly from the manufacturer in Detroit, registers the cars in Indiana, and leases to Indiana residents, those Indiana lessees would not be protected by the lemon law, a result contrary to the intention of the legislature in view of the definition of "buyer" as including a person who enters into a lease for an automobile. A construction of the word "sold" which is in harmony with the definition of "buyer" as including a lessee is reasonable and would seem to be required.

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50. IND. CODE § 24-5-13-3 (1988).

51. *Id.* § 24-5-13-3. This protection may not have been contemplated or intended by the drafters, but there is no reason why all purchasers of lemon automobiles should not be protected. If an underlying purpose of the statute is to encourage manufacturers to produce better and safer cars, the identity of the particular buyer is irrelevant.

52. See BALLENTINE'S LAW DICTIONARY 1228 (3d ed. 1969). "Sublease. A grant by a lessee of an interest . . . ."

53. Some lemon laws do not or did not include lessees within their protection. See, e.g., PA. STAT. ANN. tit. 73, § 1952 (Purdon Supp. 1988); *Industrial Valley Bank & Trust Co. v. Howard*, 368 Pa. Super. 263, 533 A.2d 1055 (1987). Prior to recent amendments to include lessees, the New York lemon law did not do so. See N.Y. GEN. BUS. LAW § 198-a(a)(1) (McKinney 1988) ("or the lessee" inserted by 1986 N.Y. Laws 799, § 1). In those states, the lessee of a lemon has no lemon law rights against the leasing company from whom he obtains the car because a lease is not a sale under the applicable lemon law. The lessee has no rights against the manufacturer because he was not the buyer of the automobile from the dealer or manufacturer. See, e.g., *Ford Motor Credit Co. v. Sims*, 12 Kan. App. 2d 363, 743 P.2d 1012 (1987) (lemon law which defined consumer as "the original purchaser" did not apply to long-term lease).

54. IND. CODE § 24-5-13-5(2) (1988).

55. *Id.* § 24-5-13-3.



### B. Defining the Lemon

Obviously, something must be seriously wrong before an automobile is a lemon and its buyer is entitled to demand a replacement or a refund. Also, in fairness, a manufacturer should have a reasonable opportunity to remedy any nonconformity before being required to take back the original automobile and either replace it or refund the purchase price. The automobile is a complex piece of machinery, and even when two cars come from the same assembly line within minutes, one may be less perfect than the other.

1. *Nonconformity*.— Most other lemon laws base the buyer's rights solely on an unremedied breach of warranty<sup>56</sup> and have been criticized for doing so.<sup>57</sup> Indiana's lemon law does not require the buyer to establish a breach of warranty in order to obtain relief, although such a breach can also trigger the buyer's lemon law rights. The Indiana statute defines the lemon as a motor vehicle suffering from an unremedied or unremediable "nonconformity"<sup>58</sup> and defines "nonconformity" as

any specific or generic defect or condition or any concurrent combination of defects or conditions that:

- (1) substantially impairs the use, market value, or safety of a motor vehicle; *or*
- (2) renders the motor vehicle nonconforming to the terms of an applicable manufacturer's warranty.<sup>59</sup>

A specific defect or condition is limited to the automobile in question and, in all likelihood, is the result of poor assembly rather than flawed design. A generic defect or condition, on the other hand, would be one which is found in many automobiles of the same make and model and may be the result of either poor assembly, flawed design, or a combination of both. Use of the alternative, "defect or

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56. See, e.g., CAL. CIV. CODE § 193.2 (West Supp. 1985) ("express warranty"); CONN. GEN. STAT. § 42-179(b) (Supp. 1987) ("applicable express warranties"); MASS. GEN. LAWS ANN. ch. 90, § 7N-1/2(2) (West Supp. 1988) ("applicable express or implied warranty"). But see MICH. COMP. LAWS ANN. § 257.1402 (West 1988) ("any defect or condition that impairs the use or value of the new motor vehicle to the consumer or which prevents the new motor vehicle from conforming to the manufacturer's express warranty").

57. See Vogel, *supra* note 2, at 589, 620-22; New Jersey's "Lemon Law", *supra* note 9, at 120.

58. See IND. CODE § 24-5-13-8 (1988).

59. *Id.* § 24-5-13-6 (emphasis added).

condition," makes clear that the buyer need not prove a specific defect as the cause of the automobile's problem.<sup>60</sup>

By including in the definition of nonconformity "a concurrent combination of defects or conditions," the lemon law includes the car that has many problems, none of which would, standing alone, be considered substantial but when taken together can be substantial.<sup>61</sup> As discussed below, the use of "concurrent" may be troublesome when construed in relation to whether the manufacturer has had a reasonable opportunity to remedy the nonconformity.<sup>62</sup> The word "concurrent" also indicates that the combination of defects or conditions must occur at the same time rather than consecutively,<sup>63</sup> thereby creating an ambiguity with respect to the car which suffers from many problems, none of which occur at the same time. The classic lemon is the car which has something different go wrong immediately after the current problem is cured. To exclude such cars from coverage would be to gut the lemon law and frustrate its purpose.

2. *Substantial Impairment*.—In order for the buyer to be entitled to replacement or refund, the nonconformity must be such that it "substantially impairs the use, market value, or safety of a motor vehicle."<sup>64</sup> The term, substantial impairment, which appears in other lemon laws as well,<sup>65</sup> is not defined. The U.C.C. uses the term in connection with revocation of acceptance but adds a subjective element,<sup>66</sup> which itself has caused some problems of interpretation and

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60. Under the U.C.C., the buyer need only show, by credible evidence, that the goods do not conform to the warranty and that the nonconformity is related to materials or workmanship. Circumstantial evidence is sufficient; there need not be proof of a specific defect. See *Universal Motors, Inc. v. Waldock*, 719 P.2d 254 (Alaska 1986).

61. For a discussion of substantial impairment and of *Zoss v. Royal Chevrolet, Inc.*, 11 U.C.C. Rep. Serv. (Callaghan) 527 (Ind. Super. Ct. 1972), see *infra* notes 64-77, 104 and accompanying text.

62. See *infra* notes 103-05 and accompanying text.

63. "[C]on-cur-rent . . . , *adj.* 1. occurring or existing together or side by side . . . ." THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 305 (unabridged ed. 1971). "[C]on-sec-u-tive . . . , *adj.* 1. following one another in uninterrupted succession or order; successive: . . . ." *Id.* at 312.

64. IND. CODE § 24-5-13-6(1) (1988) (emphasis added). Similar language appears in most of the other lemon laws, although some appear to require impairment of more than a single element of use, safety or value. See, e.g., N.M. STAT. ANN. § 57-16A-3(B) (Supp. 1985) ("use and market value").

65. See, e.g., ALASKA STAT. § 45.45.360(7) (1986); ARIZ. REV. STAT. ANN. § 44-1263A (1987); CONN. GEN. STAT. ANN. § 42-179(d) (West 1987 & Supp. 1988); MINN. STAT. ANN. § 325F.665(3)(a) (West 1981 & Supp. 1988).

66. U.C.C. § 2-608(1): "The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him . . . ." (emphasis added).



application.<sup>67</sup> How much of this subjective element has entered into decisions on revocation is unclear because most cases which have allowed revocation have involved nonconformities which meet an objective test.<sup>68</sup> Courts and scholars agree that regardless of the degree of subjectivity involved, revocation should not be available if the claimed defect is truly trivial.<sup>69</sup> A case in which a court will grant revocation based on an apparently trivial nonconformity alleged to be subjectively substantial to the revoking buyer will be rare.<sup>70</sup> On the other hand, there is the

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According to comment 2 to this section:

Revocation of acceptance is possible only where the non-conformity substantially impairs the value of the goods to the buyer. For this purpose the test is not what the seller had reason to know at the time of contracting; the question is whether the non-conformity is such as will in fact cause a substantial impairment of value to the buyer though the seller had no advance knowledge as to the buyer's particular circumstances.

*Id.* § 2-608 comment 2.

67. See, e.g., B. CLARK & C. SMITH, *THE LAW OF PRODUCT WARRANTIES*, § 7.03[3][a] (Supp. 1986); H. GREENBERG, *RIGHTS AND REMEDIES UNDER U.C.C. ARTICLE 2*, § 21.17 (1987); WHITE & SUMMERS, *supra* note 26, at § 8-4.

68. See, e.g., *Asciolla v. Manter Oldsmobile-Pontiac, Inc.*, 117 N.H. 85, 370 A.2d 270 (1977); *Jorgensen v. Pressnall*, 274 Or. 285, 545 P.2d 1382 (1976). In *Asciolla*, one of the leading cases on this issue, the court emphasized the subjective element, stated that the "needs and circumstances of the particular buyer must be examined," *Asciolla*, 117 N.H. at \_\_\_\_, 370 A.2d at 272, noted that the buyer was a "particularly prudent and painstaking car buyer," *id.* at \_\_\_\_, 370 A.2d at 273, whose confidence in the automobile had been undermined, but also noted that "the trier of fact must make an objective determination that the value of the goods to the buyer has in fact been substantially impaired." *Id.* The car had been flooded or submerged, there was ice in the transmission, water in the trunk wells, rust throughout the underside of the car, and a split ring in the transmission. The seller offered to replace the transmission, which the court said was an insufficient remedy. These facts certainly would support a finding of substantial impairment on an objective basis. In *Jorgensen*, despite the language of the court emphasizing the buyer's personal sensitivity, the facts could support a finding of substantial impairment to any reasonable buyer on an objective basis. Although the cost of repairs to the mobile home involved were small when compared to its purchase price, the mobile home was replete with defects such as water and air leaks, gaps in walls, defective doors, cabinets and walls, etc., which the seller failed to repair properly when given an opportunity to do so. *Jorgensen*, 274 Or. at \_\_\_\_, 545 P.2d at 1383.

White and Summers state that "a single standard of objective 'substantial nonconformity' will cover 99.44 percent of all rejection and revocation cases." WHITE & SUMMERS, *supra* note 26, § 8-4.

69. See, e.g., *Rozmus v. Thompson's Lincoln-Mercury Co.*, 209 Pa. Super. 120, 224 A.2d 782 (1966) (loud thumping and smoking caused by two loose engine mounting bolts); *Bill McDavid Oldsmobile, Inc. v. Mulcahy*, 533 S.W.2d 160 (Tex. Civ. App. 1976) (cracked battery); Highsmith & Havens, *Revocation of Acceptance and the Defective Automobile: The Uniform Commercial Code to the Rescue*, 18 AM. BUS. L.J. 303, 311 (1980).

70. See WHITE & SUMMERS, *supra* note 26, § 8-4. One of those rarities may be

occasional case in which the nonconformity could have been construed as objectively substantial but the fact finder determined otherwise.<sup>71</sup> Cases under both the U.C.C. and non-Indiana lemon laws may therefore be helpful if careful attention is paid to the facts.<sup>72</sup>

The new lemon law does differ from the U.C.C. in one important respect on the issue of substantial impairment. Under the U.C.C., the burden of proving substantial impairment is on the buyer who attempts to revoke acceptance.<sup>73</sup> The lemon law, however, provides that "it is an affirmative defense . . . that: (1) the nonconformity, defect, or condition does not substantially impair the use, value or safety of the

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Colonial Dodge, Inc. v. Miller, 420 Mich. 452, 362 N.W.2d 704 (1984), in which the court held that "the failure to include a spare tire with a new automobile can constitute a substantial impairment in the value of that automobile entitling the buyer to revoke his acceptance . . . ." *Id.* at —, 362 N.W.2d at 705. The buyer notified the dealer about the missing tire the day after taking delivery of his new station wagon but the dealer replied that the tire was not included because of a nation-wide shortage. It became available some months later, after the buyer revoked his acceptance. In its opinion, the court emphasized the subjective element of the substantial impairment standard and noted specifically that the buyer's occupation required him to drive 150 miles per day on Detroit freeways, often in early morning hours, that "[t]he dangers attendant upon a stranded motorist are common knowledge, and [that the buyer's] fears are not unreasonable." *Id.* at 362 N.W.2d at 707.

In view of the dealer's failure to remedy the defect immediately, its inability to do so for several months, the "common knowledge" noted by the court, and the safety related nonconformity, one wonders if the decision could not be supported on an objective standard as well.

71. See, e.g., *Koperski v. Husker Dodge, Inc.*, 208 Neb. 29, 302 N.W.2d 655 (1981). In *Koperski*, the car suffered from vibrations at thirty-five miles per hour, the motor died when air-conditioning was turned on, the engine died in reverse, and the transmission was repaired several times and then replaced twice. Nevertheless, the trial court, sitting without a jury, found no substantial impairment because on repossession and resale, the car sold for eighty-five percent of the purchase price. Query if the second buyer was an individual or a dealer and whether that buyer was told the history of the car prior to the purchase. Note the lemon law's requirements respecting resale of lemons by the manufacturer, discussed *infra* text accompanying notes 177-83.

In *Asciolla*, the master to whom the case had been referred applied a purely objective test and found no substantial impairment. 117 N.H. at —, 370 A.2d at 273. Although the court reversed because the subjective element had not been considered, the language of the court indicates that it believed that the master was wrong in denying recovery on an objective basis as well.

72. But see Goldberg, *supra* note 9, at 270-71. The author suggests that the subjective element in the Code makes the test of substantial impairment less restrictive than under the New Mexico lemon law which has no subjective element. He implies that Code cases may be inapplicable.

73. See, e.g., *Superior Wire & Paper Prods., Ltd. v. Talcott Tool & Mach., Inc.*, 184 Conn. 10, 441 A.2d 43 (1981); *Warren v. Guttanit, Inc.*, 69 N.C. App. 103, 317 S.E.2d 5 (1984); WHITE & SUMMERS, *supra* note 26, § 8-4.



motor vehicle; . . .”<sup>74</sup> Thus, pursuant to the Indiana Rules of Civil Procedure which place the burden of proof of an affirmative defense on the defendant,<sup>75</sup> the defendant manufacturer must plead and prove to the satisfaction of the fact-finder that there is no substantial impairment.<sup>76</sup>

For example, after the dealer or manufacturer’s fourth unsuccessful attempt to repair an expensive stereo system in the buyer’s automobile, the buyer has a *prima facie* claim under the lemon law which the manufacturer can defeat only if it can convince the fact finder that the nonconformity does not substantially impair the use or value of the automobile. If the manufacturer does not do so, or if it fails to plead the affirmative defense, the buyer is entitled to replacement of the car or a refund of the purchase price. It is highly likely that the issue of whether the nonconformity results in substantial impairment will be one of the more frequently disputed issues in lemon law litigation.<sup>77</sup>

3. *Breach of Warranty.*—The lemon law also contains a catch-all alternative to the “substantially impairs” standard by providing that a nonconformity may be a defect or condition that “renders the motor vehicle nonconforming to the terms of an applicable manufacturer’s warranty.”<sup>78</sup> Most manufacturers’ warranties promise only to make repairs which occur during the warranty period and are due to defects in materials or workmanship; they do not promise that the automobile is defect free, they limit the duration of implied warranties to the length of the express warranty, and they exclude consequential damages other than for personal injury,<sup>79</sup> all of which is permitted by the U.C.C.

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74. IND. CODE § 24-5-13-18 (1988).

75. IND. R. TR. P. 8(C): “A responsive pleading shall set forth affirmatively and carry the burden of proving: . . . any other matter constituting an avoidance, matter of abatement, or affirmative defense.” Cf. 1 W. HARVEY, INDIANA PRACTICE § 8.7 (2d ed. 1987).

76. A criticism of the Virginia lemon law which did not address the issue of burden of proof is that it apparently retains the Code requirement that the buyer sustain the burden of proving substantial impairment. See *Virginia’s “Lemon” Law*, *supra* note 9, at 423-24.

77. See, e.g., *Williams v. Chrysler Corp.*, 530 So. 2d 1214 (La. App.), *cert. denied*, 532 So.2d 133 (La. 1988), in which paint bubbled and flaked over sixty to seventy-five percent of a new car’s surface, two attempts at repainting were unsatisfactory, and the car was out of service for forty days. Chrysler argued unsuccessfully that the poor paint job did not substantially impair the value of the car because it could be touched up for \$250 and that it (Chrysler) should be given another opportunity to repaint the car.

78. IND. CODE § 24-5-13-6(2) (1988).

79. A General Motors Corp. warranty for 1987 provides, in pertinent part: General Motors Corporation will provide for repairs to the vehicle during the warranty period in accordance with the following terms, conditions and limi-

and the Magnuson-Moss Act.<sup>80</sup> Thus, the claim under the lemon law for nonconformity to warranty must be that the manufacturer failed to make repairs promised by the express warranty, not that the vehicle is defective.

Furthermore, Indiana decisions require that there be privity between a buyer and a remote manufacturer before the buyer has any implied warranty rights against that manufacturer.<sup>81</sup> Therefore, even though the manufacturer may be a "merchant who deals" as required for the existence of an implied warranty of merchantability,<sup>82</sup> in the usual Indiana case there will be no "applicable" implied warranty from the

tations: WHAT IS COVERED

REPAIRS COVERED

The warranty covers repairs to correct any malfunction occurring during the WARRANTY PERIOD resulting from defects in material or workmanship.

Any required adjustments will be made during the BASIC COVERAGE period.

New or remanufactured parts will be used.

The warranty booklet then describes what is included in the basic coverage for twelve months or 12,000 miles and in the major assembly coverage for an additional six years or 60,000 miles or three years or 36,000 miles, depending on the component involved, but in either case subject to a \$100 deductible.

BUICK, 1987 FRONT WHEEL DRIVE ELECTRA/PARK AVENUE AND RIVIERA NEW CAR WARRANTY AND OWNER ASSISTANCE INFORMATION 4 (1987).

Later in the booklet, the following appears in a box with heavy black borders:

OTHER TERMS: This warranty gives you specific legal rights and you may also have other rights which vary from state to state.

General Motors does not authorize any person to create for it any other obligation or liability in connection with these cars. ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE APPLICABLE TO THIS CAR IS LIMITED IN DURATION TO THE DURATION OF THIS WRITTEN WARRANTY. THE PERFORMANCE OF REPAIRS AND NEEDED ADJUSTMENTS IS THE EXCLUSIVE REMEDY UNDER THIS WRITTEN WARRANTY OR ANY IMPLIED WARRANTY. GENERAL MOTORS SHALL NOT BE LIABLE FOR INCIDENTAL OR CONSEQUENTIAL DAMAGES (FOR OTHER THAN INJURY TO THE PERSON) RESULTING FROM BREACH OF THIS WRITTEN WARRANTY OR ANY IMPLIED WARRANTY.

\*Some states do not allow limitations on how long an implied warranty will last or the exclusion or limitation of incidental or consequential damages, so the above limitations or exclusions may not apply to you. [The reference is to text above the box which states, "This warranty does not cover any economic loss . . . ."]

*Id.* at 7.

80. See *supra* text accompanying notes 21-35.

81. See, e.g., *Prairie Prod., Inc. v. Agchem Div.-Pennwalt Corp.*, 514 N.E.2d 1299 (Ind. Ct. App. 1987); H. GREENBERG, *supra* note 67. This issue is discussed *supra* note 28 and accompanying text.

82. See U.C.C. § 2-314(1).



manufacturer to the buyer and therefore no lemon law nonconformity if the automobile does not meet the test of merchantability. Although the Magnuson-Moss Act has eliminated the privity requirement in actions on the federally defined written warranty, it has not eliminated the privity requirement for enforcement of implied warranties under state law. If a state law, such as that of Indiana, requires privity, the aggrieved buyer must still demonstrate privity to support the implied warranty count of the buyer's Magnuson-Moss action.<sup>83</sup> The best solution to this problem is for the Indiana courts to hold that the lemon law demonstrates a legislative desire to eliminate the judicially created privity requirement in actions by buyers against remote automobile manufacturers to enforce implied warranty liability.

• With respect to express warranties, if the manufacturer's warranty is for twelve months or 12,000 miles, whichever is shorter,<sup>84</sup> there can be no breach of warranty if a defect or condition manifests itself thereafter but still within the lemon law's term of protection of eighteen months or 18,000 miles. This problem is alleviated by the alternative definition of nonconformity based on a defect or condition which substantially impairs, without regard to the terms of the manufacturer's warranty.

Another ambiguity with respect to the nonconformity or failure to conform to the manufacturer's warranty is created by the absence of the requirement of substantial impairment from that definition of nonconformity. A lemon law nonconformity is one that "(1) substantially impairs the use, market value, or safety of a motor vehicle; or (2) renders the motor vehicle nonconforming to the terms of an applicable manufacturer's warranty."<sup>85</sup> The placement of the numbers and the use of the disjunctive "or" indicates that a nonconformity with the manufacturer's warranty possibly need not substantially impair in order for lemon law rights to arise. It seems to follow, at least if the lemon law is construed strictly according to its language, that the manufacturer's failure to remedy a nonconformity to the terms of the warranty gives rise to the buyer's right to refund or replacement, no matter how insubstantial the nonconformity might be. The provision which establishes the manufacturer's affirmative defense of lack of substantiality<sup>86</sup> is of no assistance because this nonconformity to war-

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83. See *Abraham v. Volkswagen of America, Inc.*, 795 F.2d 238, 247 (2d Cir. 1986); *Walsh v. Ford Motor Co.*, 588 F. Supp. 1513, 1524-35 (D.D.C. 1984).

84. This has been a common new car warranty with respect to the entire car, sometimes with a longer period of warranty for the drive train and against the rusting of body parts. See, e.g., *supra* note 79 (General Motors warranty provisions).

85. IND. CODE § 24-5-13-6 (1988) (emphasis added).

86. See *supra* text accompanying note 74.

warranty standard apparently does not require substantial impairment. Such a strict reading of the language seems contrary to the spirit and intent of the statute, but the language used does allow it. The drastic remedies of replacement or refund should be available only when the nonconformity to warranty is substantial.

4. *Reasonable Opportunity to Cure*.—If, during the term of protection, the unhappy buyer reports a defect or condition to a factory authorized dealer or to the manufacturer, the manufacturer, its agent, or the dealer must make the repairs necessary to correct the nonconformity.<sup>87</sup> In the ordinary course of events, the buyer will seek warranty service from the dealer who sold the car. If there are major or repeated problems, the dealer will usually consult a manufacturer's representative. However, dealers and manufacturers, after a number of unsuccessful attempts to remedy the problems, may exhibit some reluctance to continue their efforts.<sup>88</sup> The lemon law resolves this problem by giving the manufacturer and dealer only "a reasonable number of attempts" to correct the nonconformity. If they are unable to do so, the buyer is entitled to choose between a refund or a replacement.<sup>89</sup>

The concept of a reasonable number of attempts is not new to the law. The giver of a Magnuson-Moss full warranty has a "reasonable number of attempts" to cure the nonconformity before the buyer has a right to replacement or refund.<sup>90</sup> The giver of a Magnuson-Moss limited warranty has no obligations with respect to replacement or refund except as provided under state law, namely, the U.C.C. As discussed earlier, under the U.C.C., the buyer may revoke her acceptance, return the car, and get her money back only after the limitation of remedies to repair or replacement of defective parts fails of its essential purpose.<sup>91</sup> However, there is a split in authority as to whether a buyer may revoke acceptance against a remote manufacturer or may revoke only against her immediate seller because the contract being undone was only with that seller.<sup>92</sup> In Indiana, a strict privity state,

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87. IND. CODE § 24-5-13-8 (1988).

88. See the comments of Reps. Scheuer and Eckhardt, *supra* notes 5-6 and accompanying text.

89. IND. CODE § 24-5-13-10 (1988).

90. See 15 U.S.C. § 2304(a)(4) (1982), discussed *supra* note 12 and accompanying text.

91. See the discussion of U.C.C. §§ 2-608 and 2-719, *supra* notes 19, 24 and accompanying text.

92. Compare *Durfee v. Rod Baxter Imports, Inc.*, 262 N.W.2d 349 (Minn. 1977) (permitting revocation against a remote distributor without privity) with *Gasque v. Mooers Motor Car Co.*, 227 Va. 154, 313 S.E.2d 384 (1984) (revocation available only against immediate seller); see GREENBERG, *supra* note 67, § 21.20; WHITE & SUMMERS, *supra* note 26, § 8-4, at 376-77.



it is unlikely that revocation will be available against the remote manufacturer.

Both the Code and Magnuson-Moss have left to the courts the determination of what constitutes a reasonable number of attempts. No particular number of unsuccessful attempts has been set, but "[t]he buyer of an automobile is not bound to permit the seller to tinker with the article indefinitely in the hope that it may ultimately be made to comply with the warranty."<sup>93</sup> This issue has been settled by the lemon law provision which states that a reasonable number of attempts have occurred either when "the nonconformity has been subject to repair at least four (4) times . . . , but the nonconformity continues to exist" or "the vehicle is out of service by reason of repair of any nonconformity for a cumulative total of at least thirty (30) business days, and the nonconformity continues to exist."<sup>94</sup>

The first of these standards of "reasonable number of attempts" may be interpreted to give to the manufacturer four opportunities to correct a particular nonconformity, regardless of the nonconformity's seriousness, its effect on the vehicle's safety, or a reasonable buyer's confidence in continued use of the vehicle.<sup>95</sup> In effect, the lemon law has rejected the "shaken faith doctrine," a concept developed under the U.C.C. that the failure of the authorized dealer or manufacturer to cure a defect of major consequence the first time may be sufficient to trigger the buyer's right to replacement or refund.<sup>96</sup>

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93. *Orange Motors of Coral Gables, Inc. v. Dade County Dairies, Inc.*, 258 So. 2d 319, 321 (Fla. Dist. Ct. App. 1972), *cert. denied*, 263 So. 2d 831 (Fla. 1972) (citing 46 AM JUR. *Sales* § 732; 77 C.J.S. *Sales* § 340); *accord* *Zoss v. Royal Chevrolet, Inc.*, 11 U.C.C. Rep. Serv. (Callaghan) 527, 532-33 (Ind. Super. Ct. 1972); *Rester v. Morrow*, 491 So. 2d 204, 210 (Miss. 1986) (stating that the cases in accord are "legion").

94. IND. CODE § 24-5-13-15(a)(1),(2) (1988). Most lemon laws provide the same test for reasonable number of attempts. *But see, e.g.*, FLA. STAT. ANN. § 681.104(3)(a) (West 1985) (three attempts or fifteen business days); ME. REV. STAT. ANN. tit. 10, § 1163(3) (Supp. 1987) (same); MISS. CODE ANN. § 63-17-159(3) (Supp. 1988) (same).

95. *See Sepulveda v. American Motors Sales Corp.*, 137 Misc. 2d 543, 521 N.Y.S.2d 387 (N.Y. Civ. Ct. 1987) (Car had several minor stalling incidents before dying on expressway; one hour after repairs, the same thing happened. The court ruled that under New York lemon law, a reasonable number of attempts to repair was set at four, which had not yet occurred, and buyer failed to show that defect could not be repaired.).

96. The doctrine was first espoused in *Zabriskie Chevrolet, Inc. v. Smith*, 99 N.J. Super. 441, 240 A.2d 195 (1968), in which the buyer's brand new car exhibited serious transmission problems within less than a mile from the dealership and became inoperative shortly thereafter because of a "remarkable" transmission defect. *Id.* at 457, 240 A.2d at 204. The seller replaced the transmission with one from a car in its showroom. The buyer refused to take the car and insisted that the transaction was cancelled. The court observed that the defect could not be cured by substituting a transmission "of unknown

Under the lemon law, a buyer whose faith in the automobile has been shaken must wait until the manufacturer has failed to correct the nonconformity four times before her lemon law rights are triggered and she is entitled to a refund or replacement. If the third attempt to repair is successful, there are no lemon law rights regardless of the reasonable apprehension of the buyer as to the integrity and safety of the automobile in question. Under the U.C.C. and the shaken faith doctrine, the buyer need only demonstrate to the satisfaction of the fact finder that the seller failed to remedy the nonconformity, thereby causing the limited remedy or repair or replacement to fail of its essential purpose, and that her faith in the car is shaken, in order to revoke acceptance and obtain a refund plus damages.<sup>97</sup>

At the very least, if the nonconformity substantially affects the safety of the automobile and the first attempt by the manufacturer or its authorized dealer to remedy the nonconformity is unsuccessful, the manufacturer should not have another three opportunities to remedy the problem. The buyer should not have to drive the unsafe automobile until after the manufacturer's fourth unsuccessful attempt. One unsuccessful attempt should be enough, as provided in the Minnesota lemon law.<sup>98</sup> Moreover, although most lemon laws do limit the number of repair attempts to four, there is no justification for giving the dealer and/or manufacturer more than one or two opportunities to cure a serious problem. They are the experts. Giving the manufacturer, through

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lineage." The court continued:

For a majority of people the purchase of a new car is a major investment, rationalized by the peace of mind that flows from its dependability and safety. Once their faith is shaken, the vehicle loses not only its real value in their eyes, but becomes an instrument whose integrity is substantially impaired and whose operation is fraught with apprehension.

*Id.* at 458, 240 A.2d at 205; *accord, e.g.*, *Stridiron v. I.C., Inc.*, 578 F. Supp. 997, 1000 (D.V.I. 1984); *Sauers v. Tibbs*, 48 Ill. App. 3d 805, 363 N.E.2d 444, 448 (1977); *Champion Ford Sales, Inc. v. Levine*, 49 Md. App. 549, —, 433 A.2d 1218, 1224 (1981); *Gappelberg v. Landrum*, 666 S.W.2d 88, 90-91 (Tex. 1984); *see, e.g.*, *Asciolla v. Manter Oldsmobile-Pontiac, Inc.* 117 N.H. 85, 370 A.2d 270 (1977).

97. *See WHITE & SUMMERS, supra* note 26, § 8-5.

98. MINN. STAT. ANN. § 325F.665(3)(c) (West 1988) states:

If the nonconformity results in a complete failure of the braking or steering system of the new motor vehicle and is likely to cause death or serious bodily injury if the vehicle is driven, it is presumed that a reasonable number of attempts have been undertaken to conform the vehicle to the applicable express warranties if the nonconformity has been subject to repair at least once by the manufacturer, its agents, or its authorized dealers . . . .

Connecticut's Lemon Law gives the manufacturer two opportunities to cure "if a motor vehicle has a nonconformity which results in a condition which is likely to cause death or serious bodily injury if the vehicle is driven." CONN. GEN. STAT. ANN. § 42-179(f) (West Supp. 1988). *See Goldberg, supra* note 9, at 269-70.



its authorized dealer, more than two opportunities to repair any substantial nonconformity provides little incentive for improvement of the quality of cars or of the service provided by dealers.<sup>99</sup>

A further issue for judicial resolution is whether the nonconformity unsuccessfully repaired on each of the four attempts must be precisely the same nonconformity or may be less specific. For example, if the motor stopped running when the accelerator was depressed, must the evidence show that the problem was caused by the fuel system computer each of the four times, or is it sufficient to show that regardless of the specific defect, the car stopped running when the accelerator was depressed? And what if the manufacturer can show that on the first two occasions, the problem was caused by a defective fuel system computer and that on the third and fourth occasions, it was caused by improper spark plug adjustments or some other reason?<sup>100</sup> The lemon law's use of the alternative "defect *or* condition"<sup>101</sup> indicates that the broader approach is intended, but just how broad an approach is not clear. Regardless of the approach, it may be necessary for the aggrieved buyer to be prepared with expert evidence that each of the problems was substantially similar to the other.

The second standard of "reasonable number of attempts" is met when the vehicle has been out of service "for a cumulative total of at least thirty (30) business days, and the nonconformity continues to exist."<sup>102</sup> The definition of nonconformity which includes "any concurrent combination of defects or conditions"<sup>103</sup> indicates that this standard is likely aimed at the automobile that suffers from a series of problems, each of which may be remedied individually, but which, taken together, require more than thirty days of service. These may also be defects which, although not individually substantial, when taken

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99. See Vogel, *supra* note 2, at 633-34.

100. See *Levinger v. General Motors Corp.*, 122 A.D.2d 419, 504 N.Y.S.2d 819 (1986). In this New York lemon law case, the buyer's new car suffered motor failure on five separate occasions, two of which required that it be towed in. After the fifth failure, the buyer refused to accept return of the car and demanded a refund. With respect to the buyer's motion for summary judgment, the appellate division observed that there is a statutory presumption of the manufacturer's inability to correct the defect after four unsuccessful attempts; however, it must be the same nonconformity, defect or condition. "General Motors submitted evidence . . . creating triable issues as to whether, on the various occasions when the vehicle was brought in for repair, the complaints related to the same malfunction or whether, instead, each such mechanical failure presented a different defect which was corrected in turn by the dealer." *Id.* at 421, 504 N.Y.S.2d at 822.

101. IND. CODE § 24-5-13-6 (1988) (emphasis added).

102. *Id.* § 24-5-13-15(a)(2).

103. *Id.* § 24-5-13-6.

together do indicate serious problems with the automobile and do substantially impair its value.<sup>104</sup>

If the nonconformity results from a single defect or condition which keeps the vehicle out of service for thirty cumulative days or more, but which the manufacturer or dealer successfully repairs before the buyer demands the lemon law right to refund or replacement, the language of the lemon law indicates that the buyer will not be entitled to relief thereunder. It is only when the "nonconformity continues to exist" that lemon law rights are available. The buyer must assert his or her rights before the dealer or manufacturer has repaired the vehicle.<sup>105</sup>

### C. Disclosure Requirements

All lemon laws require that the manufacturer inform the buyer of his or her rights in some manner. Indiana's Law states:

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104. See, e.g., *Zoss v. Royal Chevrolet, Inc.*, 11 U.C.C. Rep. Serv. (Callaghan) 527 (Ind. Super. Ct. 1972); *Murray v. Holiday Rambler, Inc.*, 83 Wis. 2d 406, 265 N.W.2d 513 (1978). In *Zoss*, the court stated:

Here many of the non-conformities were not in and of themselves substantial. However, the cumulative effect of all the non-conformities, so impaired the value of the commercial unit [a Corvette] as to constitute a substantial impairment to plaintiffs. 11 U.C.C. Rep. Serv. (Callaghan) at 532.

The nonconformities included:

"imperfections in the exterior finish including scratches, pits or pock marks; an electrical problem dealing with the door ajar light and built-in burglar alarm causing malfunction; upholstery damage caused by defendant [dealer] during repair of other matters; a front end rattle; squeaky emergency brake; bumper scratches and corrosion; extensive paint overspray on glass, transmission console and dash area; inadequate sealing at windows permitting water leakage; faulty window weather stripping; dash board rattle; luggage rack improperly installed and popping free; frayed carpeting near seat track on driver's side in front; paint peel on backs of seats and on some of the interior panels; convertible top hold down bracket missing; red paint stains on white convertible top; defective rubber weather stripping around door handles and door lock; paint overspray on exhaust pipe; water leakage through hole where rear view mirror is attached to ceiling; non-functional windshield wiper; improperly functioning coverlet for windshield wipers; rusting luggage rack; crushed front bumper support; small dents in chrome stripping; faulty engine adjustment causing wear out of spark plugs and points in three thousand miles, excessive gas consumption; and improperly manufactured rear quarter panel.

*Id.* at 529.

105. See *Bailey v. Ford Motor Co.*, 135 Misc. 2d 901, 516 N.Y.S.2d 887 (N.Y. Sup. Ct. 1987), in which the buyer's new pickup truck was out of service for fifty-three days, but the buyer waited until the repairs were completed before insisting on a refund under the New York Lemon Law. The court held that the lemon law did not apply because the truck had been repaired, apparently successfully. *Id.* at 904, 516 N.Y.S.2d at 809.



The manufacturer shall clearly and conspicuously disclose to the buyer, in the warranty or owner's manual, that written notification of the nonconformity is required before the buyer may be eligible for a refund or replacement of the vehicle. The manufacturer shall include with the warranty or owner's manual the name and address to which the buyer must send notification.<sup>106</sup>

Should the manufacturer fail to comply, the buyer need not notify it of the claim before pursuing the lemon law remedies.<sup>107</sup>

A manufacturer's disclosure which meets these lemon law requirements may not be sufficient to inform the buyer what his or her rights are and when they may be exercised.<sup>108</sup> The example quoted in the preceding footnote may satisfy the lemon law's disclosure requirements but tells the buyer nothing about when lemon law rights arise and how to pursue them. As one critic has noted, studies have shown that this type of notice included in a warranty booklet or even on a separate piece of paper, which the dealer must hand to the buyer, has been insufficient to inform buyers of their rights.<sup>109</sup> She suggests advertising in the print and electronic media to advise consumers of their rights

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106. IND. CODE § 24-5-13-9(b) (1988).

107. *See id.* § 24-5-13-9(a).

108. For example, the 1988 G.M. Chevrolet, 1988 Ford/Mercury and 1988 Toyota warranty booklets each state that a dissatisfied buyer may contact the manufacturer for assistance with problems, and describe the manufacturer's arbitration programs. However, the booklets do relatively little to call the buyer's attention to the possibility of replacement of the vehicle or refund of the purchase price, the remedies available under most lemon laws which preceded the 1988 Indiana Lemon Law. *See FORD MOTOR COMPANY WARRANTY INFORMATION BOOKLET*, 1988 FORD AND MERCURY CARS AND FORD LIGHT TRUCKS 31-33; 1988 WARRANTY AND OWNER ASSISTANCE INFORMATION, GM 6/60 QUALITY COMMITMENT PLAN FOR CHEVROLET NEW CARS 16-21 [hereinafter CHEVROLET BOOKLET]; TOYOTA 1988 OWNER'S GUIDE 14-15.

The Chevrolet booklet states:

Laws in many states permit owners to obtain a replacement vehicle or a refund of the purchase price under certain circumstances. The provisions of these laws vary from state to state. To the extent allowed by state law, General Motors requires that you first provide us with written notification of any service difficulty you have experienced covered by state law so that we may have an opportunity to make any needed repairs before you are eligible for the remedies provided by these laws. In all other states, we request that you give us the written notice. Your written notification should be sent to the nearest Branch Office listed on pages 17 and 18, except Branches with toll-free (800) numbers. In that case, correspondence should be sent to the Customer Assistance Center, as listed on page 21.

CHEVROLET BOOKLET, *supra*, at 17.

109. *See Vogel, supra* note 2, at 616, 646.

in campaigns similar to those employed by government agencies with respect to other products or issues.<sup>110</sup> Her point is well taken.

The publicity which accompanied the enactment of the lemon law in February 1988, may have stirred the interest of the public and the media temporarily,<sup>111</sup> but as time passes, that interest will shift to other issues. Buyers will forget about the lemon law until it becomes necessary to contact a TV station's consumer affairs reporter or an attorney. By that time, valuable rights may have been inadequately protected or even lost.

Another appropriate method of informing a buyer of her rights would be for a statutory amendment authorizing the attorney general to prepare a simple sticker outlining the buyer's rights and to require that it be affixed to the windshields of all new automobiles delivered to buyers in Indiana.<sup>112</sup>

#### *D. Notice Requirements*

The notice requirements of the lemon law are somewhat confusing and may mislead an unsuspecting buyer into believing that he or she has complied with those requirements when, in fact, the buyer has not. If the buyer "reports" a nonconformity to the manufacturer, its agent, or its authorized dealer, during the term of protection, the manufacturer, agent or dealer "shall make the repairs that are necessary to correct the nonconformity, even if the repairs are made after expiration of the term of protection."<sup>113</sup> Typically, the buyer makes this report when he or she takes the car for service to the authorized dealer from which it was purchased and the buyer tells the service writer what the car is or is not doing.

In order to exercise her right to a refund or replacement after a reasonable number of opportunities to repair have passed, however, the "buyer must first notify the manufacturer of a claim under this chapter," *provided* that the manufacturer has complied with the lemon law's disclosure requirements.<sup>114</sup> If the manufacturer does not disclose the required information, "the buyer is not required to notify the manufacturer of a claim" under the lemon law.<sup>115</sup>

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110. *See id.* at 646-47.

111. One Indianapolis television station has prepared a leaflet which describes the lemon law, buyers' rights under it, and what to do in the event of a problem. *See* INDIANA'S NEW CAR LEMON LAW, WRTV, INDIANAPOLIS (1988).

112. *See New Jersey's "Lemon Law," supra* note 9, at 128.

113. IND. CODE § 24-5-13-8 (1988).

114. *Id.* § 24-5-13-9.

115. *See id.* § 24-5-13-9(a).



The interrelationship of these two notice requirements raises several issues. When must this second notice be given to the manufacturer? The reason for any notice to the manufacturer initially seems to be to enable it to apply its repair expertise to the nonconformity. But if this required written notice is not given to the manufacturer until after the authorized dealer has failed to remedy the nonconformity a fourth time, does the manufacturer still have a further opportunity to attempt a remedy before it must refund or replace?<sup>116</sup> Since the Act states that four unsuccessful attempts by the manufacturer, its agent, *or* its authorized dealer constitute a reasonable number, the buyer should not be required to await a fifth unsuccessful attempt.<sup>117</sup>

When the dealer does warranty work pursuant to the manufacturer's written warranty, the dealer is acting as the manufacturer's agent for the purposes of that warranty work and is reimbursed for it. In the vast majority of cases, the dealer submits to the manufacturer a claim for reimbursement for work done under the manufacturer's warranty. Consequently, the manufacturer will already have a record of the automobile's problems. In addition, if the dealer is unable to remedy a particular problem or the nonconformity is unusual, the ordinary course of action is for the dealer to consult a factory representative. Under these circumstances, the requirement of an additional notice in writing seems to be redundant at best and one which a buyer may reasonably assume is not necessary because the manufacturer already knows that the car is a lemon.<sup>118</sup> The purpose of this second notice should be nothing more than to advise the manufacturer of the buyer's choice between replacement and refund. If the manufacturer, through its dealer or regional representative, has knowledge of the buyer's choice, the requirement of a written notice and the notice itself seem unnecessary.

New York has eliminated this problem of double notice by requiring only that the buyer "report the nonconformity, defect or condition to the manufacturer, its agent or its authorized dealer."<sup>119</sup> If the notice is given to the agent or dealer, the agent or dealer must forward notice to the manufacturer within seven days by certified mail.<sup>120</sup> If the agent

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116. See Goldberg, *supra* note 9, at 268-69 n.90.

117. But see, e.g., 1988 ACURA WARRANTIES 3, which states, in part: Generally, before making a request for a replacement or a refund, the owner must submit a written explanation of the problem to the Acura Customer Relations office, and give the dealer *and* Acura an opportunity to solve it. (emphasis added).

118. See Goldberg, *supra* note 9; Vogel, *supra* note 2, at 624.

119. N.Y. GEN. BUS. LAW § 198-a(b) (McKinney Supp. 1988).

120. *Id.* See Mountcastle v. Volvoville, USA, Inc., 130 Misc. 2d 97, 494 N.Y.S.2d

or dealer fails to do so, that is a matter between it and the manufacturer; the buyer's rights are not affected.

There may also be a problem harmonizing the notice requirements of the lemon law with those of the U.C.C. The buyer who seeks to revoke acceptance under the U.C.C. must give notice of revocation within a reasonable time after he or she discovers or should have discovered the nonconformity.<sup>121</sup> However, under the lemon law, the buyer's notice to the manufacturer of her election to undo the transaction and receive a refund may be given at any time during the term of protection but clearly may not be given until after the fourth unsuccessful repair attempt or thirty cumulative days in the shop. Thus, the buyer will be faced with a dilemma such as that encountered by the buyers in *Sepulveda v. American Motors Sales Corp.*,<sup>122</sup> who became aware of a stalling problem almost three months before their new car died on an expressway. The dealer's attempt at repair was unsuccessful. The New York trial court held that the single unsuccessful repair did not trigger the buyers' lemon law rights and that the notice of revocation under the U.C.C. some three months after buyers became aware of the nonconformity was not given within a reasonable time. The court appropriately stated that the buyers had "a Scylla and Charybdis problem" because if they did not revoke at the very first evidence of defect which substantially impairs, they may lose their U.C.C. rights, but if they attempt to revoke too soon, they have no lemon law rights.

The appropriate solution would be for courts to hold that by enacting the lemon law, the legislature has determined that a reasonable time for notice of revocation of acceptance of a nonconforming automobile is the time within which a lemon law demand for refund must be given.

### *E. Alternative Dispute Resolution*

The buyer of a lemon is precluded from seeking any judicial relief under the lemon law if he or she fails to resort first to any informal dispute resolution procedure established or participated in by the manufacturer; provided that "the procedure is certified by the attorney general as complying in all respects with 16 C.F.R. 703 and the buyer has received adequate written notice from the manufacturer of the

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792 (N.Y. Sup. Ct. 1985), in which the court ruled that the failure of the dealer to forward notice to the manufacturer may be relevant to a claim between the manufacturer and the dealer but would not adversely affect the buyer's demand for refund from the manufacturer.

121. U.C.C. § 2-608(2).

122. 137 Misc. 2d 543, 521 N.Y.S.2d 387 (N.Y. Civ. Ct. 1987).



existence of the procedure.”<sup>123</sup> The description of what notice from the manufacturer is adequate is ambiguously worded:

Adequate written notice includes the incorporation of the informal dispute settlement procedure into the terms of the written warranty *to which the motor vehicle does not conform*.<sup>124</sup>

The reference to 16 C.F.R. 703 is to the informal dispute settlement procedures which are part of the regulations promulgated by the Federal Trade Commission pursuant to the mandate of the Magnuson-Moss Act.<sup>125</sup> Many lemon laws have adopted this federal standard for alternative dispute resolution procedures.<sup>126</sup>

The emphasized portion of the lemon law language above presumes nonconformity to the written warranty, which may or may not be the case. As noted earlier, the lemon law has de-emphasized nonconformity to any warranty in favor of a defect or condition which substantially impairs use, safety or value.<sup>127</sup> Also, it is possible for lemon law rights to exist even after the written warranty expires, as where the problem condition of the automobile does not manifest itself until 15,000 miles, but the written warranty expired at 12,000. To avoid confusion, the reference to nonconformity to warranty should be deleted.

Moreover, the lemon law should require specifically that the notice be both conspicuous and understandable by the average buyer. Although the federal regulation requires that notice thereunder disclose the availability of the informal procedure “clearly and conspicuously . . . on the face of the written warranty,”<sup>128</sup> the lemon law provision may have created its own requirement by stating where the notice may be placed. Absent a specific requirement of conspicuousness, it is possible for a court to hold that as long as the notice contains the necessary information and is given to the buyer in the written warranty, it need not be conspicuous.<sup>129</sup>

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123. IND. CODE § 24-5-13-19 (1988).

124. *Id.* (emphasis added).

125. See 15 U.S.C. §§ 2309, 2310 (1982); 16 C.F.R. § 703.1 (1988).

126. See, e.g., N.J. STAT. ANN. § 56:12-25 (West 1987); Vogel, *supra* note 2, at 648-49 (all but two states have adopted the federal procedures). One major exception is Texas, which has established a state agency to hear the complaints of lemon buyers. See TEX. REV. CIV. STAT. ANN. art. 4413(36), § 3.02-.06 (Vernon 1985); Comment, *A New Twist for Texas “Lemon” Owners*, 17 ST. MARY’S L.J. 155, 173-79 (1985).

127. See *supra* notes 56-72 and accompanying text.

128. 16 C.F.R. § 703.2(1) (1988).

129. Cf. *Hahn v. Ford Motor Co.*, 434 N.E.2d 943, 948 n.2 (Ind. Ct. App. 1982), in which the court observed that although the U.C.C. requires in § 2-316(2) that disclaimers of implied warranties be conspicuous, the failure of the Code to require conspicuousness in the section on limitation of remedies, § 2-719, meant that such limitations were effective even if not conspicuous.

Also, the use of the word "procedure" in the requirement that the attorney general "certify" compliance creates an ambiguity with respect to how much of the federal regulation is actually to be followed. Does this mean only the manner in which the panels are constituted and conduct their business, or does it mean every aspect of the federal informal dispute resolution regulation, including the giving of notice? And what happens if the FTC changes its regulations?

Although the FTC regulations stress that the mechanism for dispute resolution should insure fair and expeditious settlement of disputes,<sup>130</sup> the regulations have been attacked by some scholars as authorizing the creation of panels and procedures which are vulnerable to manufacturer influence and impose an additional, expensive barrier for buyers to overcome before they can obtain the relief to which they are entitled.<sup>131</sup> Moreover, the FTC has apparently done little to insure compliance or fairness.<sup>132</sup>

The mechanism described in the regulations is supported financially by the manufacturer; the consumer may not be charged any fee for participation.<sup>133</sup> Although all members of one or two person panels and two-thirds of three member panels are prohibited from having direct involvement with the automobile business, and no member of the panel may be a party to the dispute, the panel members may be employees of the manufacturer "for purposes of deciding disputes."<sup>134</sup> It is highly unlikely that manufacturers will include on the list of panelists—some of whom they pay—anyone overly antagonistic or unsympathetic to their position.<sup>135</sup> The training given prospective panelists has been criticized as often being minimal.<sup>136</sup> Moreover, unless the buyer is represented by counsel in the informal proceeding, a matter discussed below in connection with recovery of attorney's fees,<sup>137</sup> the inexperienced buyer will likely be opposed by a manufacturer's expert who has substantial experience in presenting the manufacturer's position. It may also be necessary for the buyer to retain an expert to

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130. See 16 C.F.R. §§ 703.3(c), 703.4(c) (1988).

131. See, e.g., Sklaw, *supra* note 9, at 158; Vogel, *supra* note 2, at 648-760; *A Sour Note*, *supra* note 9, at 879; *New Jersey's "Lemon Law," supra* note 9, at 118-19.

132. See, e.g., C. REITZ, *CONSUMER PRODUCT WARRANTIES UNDER FEDERAL AND STATE LAWS* 190 (2d ed. 1987).

133. 16 C.F.R. § 703.3(a) (1988).

134. See 16 C.F.R. § 703.4 (1988). Subsection (a) states: "No member deciding a dispute shall be: (1) A party to the dispute, or an employee or agent of a party other than for purposes of deciding disputes." The likelihood of the panel member being an agent or employee of the buyer is rather remote.

135. See Vogel, *supra* note 2, at 651-52.

136. See *id.* at 652 n.311.

137. See *infra* notes 164-70 and accompanying text.



deal with the manufacturer's claims, for example, that each of the four repair attempts were not related to the same nonconformity or that each attempt, in itself, was successful.<sup>138</sup>

The federal regulations state that a decision rendered in the informal proceeding is not legally binding but it is admissible "in any civil action arising out of a warranty obligation considered by the [panel]."<sup>139</sup> If the procedure only slightly favors the manufacturer, the burden placed on the buyer to convince the judicial fact-finder that the panel's decision was wrong is a heavy one indeed. Further, the admissibility of the decision and its weight are not addressed directly by the lemon law. As noted earlier, it is unclear if all of the federal procedures, including the appeal and admissibility provisions, are incorporated into the lemon law.

At the time of this writing, the Indiana Attorney General has not yet certified any manufacturer's alternative dispute resolution procedure. The experience in Connecticut, which originally required certification by the state attorney general of full compliance with the FTC regulations,<sup>140</sup> has been that none of the manufacturers' programs during the past three years have been certifiable.<sup>141</sup> Consequently, the Connecticut legislature revised its lemon law to provide for an "independent arbitration procedure" created by the state department of consumer protection.<sup>142</sup>

Similarly, some lawmakers in New Jersey, whose lemon law also requires conformity to the federal regulation,<sup>143</sup> have found that the

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138. See *Levinger v. General Motors Corp.*, 122 A.D.2d 419, 504 N.Y.S.2d 819 (App. Div. 1986); discussed *supra* note 100.

139. 16 C.F.R. § 703.5(j) (1988).

140. See CONN. GEN. STAT. ANN. § 42-182(a) (West 1987).

141. See U.P.I. Wire Service, BC Cycle, Regional News, April 7, 1988 (NEXIS search, *supra* note 4).

142. See CONN. GEN. STAT. ANN. § 42-181(a) (West Supp. 1988):

The department of consumer protection, shall provide an independent arbitration procedure for the settlement of disputes between consumers and manufacturers of motor vehicles which do not conform to all applicable warranties under the terms of section 42-179. The commissioner shall establish one or more automobile dispute settlement panels which shall consist of three members appointed by the commissioner . . . , only one of whom may be directly involved in the manufacture, distribution, sale or service of any product. Members shall be persons interested in consumer disputes and shall serve without compensation for terms of two years at the discretion of the commissioner. In lieu of referring an arbitration dispute to a panel established under the provisions of this section, the department of consumer protection may refer an arbitration dispute to the American Arbitration Association in accordance with regulations adopted in accordance with the provisions of [an arbitration statute].

143. See N.J. STAT. ANN. § 56:12-25, -26 (West Supp. 1988).

manufacturers' procedures are ineffective, take as long as the trials they were intended to replace, and create roadblocks for consumers. Consequently, they propose to amend the law so that complaints will go to an administrative law judge rather than to arbitration.<sup>144</sup>

Finally with respect to dispute resolution, the manufacturers are apparently not pleased with the various lemon laws. In April 1988, a coalition of the Motor Vehicle Manufacturers Association and the Automobile Importers Association of America submitted a proposal to the Federal Trade Commission which would establish federally administered dispute resolution guidelines in an effort, according to an industry spokesman, to "get around different states having different rules."<sup>145</sup> Other parties, such as the Attorney General of Minnesota, view the manufacturers' action as a "back door attempt to strip car buyers of the legal rights that states have given to consumers."<sup>146</sup> In view of the FTC's inability or unwillingness to police the informal dispute resolution mechanisms already established under the Magnuson-Moss Act, the latter view appears to be the more accurate.<sup>147</sup>

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144. See U.P.I. Wire Service, BC Cycle, Regional News, February 29, 1988 (NEXIS search, *supra* note 4).

145. The Washington Post, April 12, 1988, at C1.

146. U.P.I. Wire Service, BC Cycle, Regional News, April 12, 1988 (NEXIS search, *supra* note 4).

147. It should be noted that any attempt to strengthen the applicable alternative dispute resolution programs beyond the requirements of the FTC Magnuson-Moss regulations or action may encounter judicial opposition. In two recent cases, the United States District Court for the Southern District of New York ruled that provisions of the New York Lemon Law which added requirements beyond those established by the FTC were invalid under the supremacy clause of the U.S. Constitution because of federal pre-emption of the field.

In *Motor Vehicle Mfrs. Ass'n of the United States v. Abrams*, 1988-2 Trade Cas. (CCH) § 68,290 (S.D.N.Y. 1988), the court ruled that to the extent New York's lemon law imposed alternative dispute resolution requirements on manufacturers which were more burdensome than those imposed by the FTC regulations, the lemon law was preempted by those regulations as a matter of federal supremacy. Included in the invalid New York requirements were such things as mandatory oral hearings and binding arbitration, record keeping, additional training for the arbitrators, and a buyer's "bill of rights" to be disclosed by the manufacturer to the buyer, none of which was required by the FTC regulations.

And in *General Motors Corp. v. Abrams*, No. 86 Civ. 9193 (S.D.N.Y. Jan. 19, 1989) (1989 U.S. Dist. LEXIS 506), the court declared that a consent decree between General Motors and the FTC pursuant to which G.M. agreed "to implement a nationwide third-party arbitration program to settle complaints of individual owners relating to powertrain components" superseded the New York Lemon Law's alternative dispute resolution requirements. *General Motors Corp.*, 1989 U.S. Dist. LEXIS 506 at p. 5 (quoting *In re General Motors Corp.*, 102 F.T.C. 1741, 1761 (1983)). Among the lemon law requirements to which G.M. objected were that the alternative dispute resolution proceeding must be



*F. The Lemon Buyer's Recovery.*

1. *Refund or Replacement.*—The heart of the lemon law is that if the manufacturer is unable or unwilling to correct the nonconformity after a reasonable number of attempts, the buyer may return the car to the manufacturer and demand either a refund of the purchase price or a replacement of comparable value, a demand with which the manufacturer must comply within thirty days.<sup>148</sup> The Indiana lemon law has resolved some problems existing under other state lemon laws by specifying that a refund must be the full contract price, including the value of any trade-in, as well as incidental expenses such as sales tax, unexpended portions of prepaid fees and taxes, expended finance charges, and the cost of any dealer-installed optional equipment.<sup>149</sup>

However, the Act contains no provision for the recovery of any consequential damages other than towing or car rental costs,<sup>150</sup> such as for time missed from work or lodging expenses in the event of a

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conducted by arbitrators trained and familiar with the lemon law and that the lemon law remedies of replacement or refund be made available in the arbitration proceeding is appropriate. G.M. had agreed to proceedings sponsored by the Council of Better Business Bureaus, described by an officer of B.B.B. as follows:

Having heard the parties, the arbitrators "are then free to make common sense adjudications based on their own sense of fairness." . . . "They are not taught the various state laws which would apply if the disputes they were hearing had been brought in court. In fact, while the arbitrators are told that they may allow parties to present the substantive law from the state where they are sitting or even from other states, they are specifically instructed that they are not to apply any particular law, but instead are to do what they personally believe is right."

*Id.* at 22 (quoting affidavit Dean W. Determan, General Counsel and Vice President, Mediation/Arbitration Div., B.B.B.).

At the present time, the Indiana Lemon Law requires only that the attorney general certify compliance with the FTC regulations. However, if these decisions are correct, FTC approval preempts that certification. Moreover, if Indiana follows the course of New York in attempting to remedy the problems perceived in programs which adhere solely to the FTC requirements, that attempt may be in serious jeopardy. The alternatives available seem to be either enforcement of the Indiana Lemon Law in the courts or establishment of a state run alternative dispute resolution system for lemon law cases. *See Bourdreaux v. Ford Motor Co.*, No. 88-CC-0864 (La. Nov. 14, 1988) (1988 La. LEXIS 2003, p. 13).

148. IND. CODE § 24-5-13-10 (1988).

149. *Id.* § 24-5-13-11(a), (c). This alleviates the type of problem which arose in *Haddad v. Commissioner of Revenue*, 25 Mass. App. Ct. 917, 515 N.E.2d 1204 (1987), in which, under the then applicable Massachusetts Lemon Law, the manufacturer did not include in the refund the sales tax on the buyer's new Corvette. The buyer bought a replacement automobile, paid sales tax on it, and sought to recover the sales tax on the Corvette from the state. The appellate court affirmed the decision of the tax board against the buyer. Had the Massachusetts Lemon Law included a return of sales tax paid, the issue would not have arisen.

150. *See* IND. CODE § 24-5-13-13 (1988).

breakdown away from home, which may be available under the Code as consequential damages,<sup>151</sup> or for punitive damages, which may be available if the dealer or manufacturer has acted improperly toward the buyer in handling the buyer's complaints.<sup>152</sup>

If the aggrieved buyer elects to receive a replacement of "comparable value" rather than a refund, there is nothing in the lemon law to indicate what comparable value means, that is, whether it means a new car identical to the lemon (which may also be a lemon because of a generic condition), a new car similar to the lemon but with different equipment if an identical car is not available, or a used non-lemon in the same condition and with the same mileage as the returned lemon.<sup>153</sup> The Magnuson-Moss Act, which mandates refund or replacement of a lemon under a full warranty,<sup>154</sup> defines replacement as "furnishing a *new* consumer product which is identical or reasonably equivalent to the warranted consumer product."<sup>155</sup> Some state lemon laws also require that the replacement be new.<sup>156</sup> The protection of the lemon buyer would best be served if the replacement were required to be a new car, less an allowance for use of the lemon, as discussed in the next paragraph. However, the statutory formula for that use speaks only of refunds.

Until the manufacturer has complied with the buyer's demand for refund or replacement, the buyer may continue to use the lemon, although the manufacturer is entitled to deduct from any refund a credit for that use.<sup>157</sup> This resolves a problem under the U.C.C. as to whether the continued use of goods after revocation of acceptance nullifies the revocation.<sup>158</sup>

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151. See U.C.C. § 2-715.

152. See *Bud Wolf Chevrolet, Inc. v. Robertson*, 519 N.E.2d 135 (Ind. 1988); *Hibschman Pontiac, Inc. v. Batchelor*, 266 Ind. 310, 362 N.E.2d 845 (1977). In *Bud Wolf*, punitive damages were awarded when the dealer sold as a "new" truck one which had been wrecked while on the dealer's new car lot, but did not disclose the damage to the buyer. 519 N.E.2d at 136. In *Hibschman*, because of multiple and recurring defects, the buyer lost use of his new car for forty-five days and was told that repairs had been made when they had not been. The dealer told the buyer, "I would rather you would just leave and not come back. We are going to have to write you off as a bad customer." 266 Ind. at 315-16, 362 N.E.2d at 847.

153. See Rigg, *supra* note 2, at 1155.

154. 15 U.S.C. § 2304(a)(4) (1982).

155. *Id.* § 2301(11) (emphasis added).

156. See, e.g., CONN. GEN. STAT. ANN. § 42-179(d) (West Supp. 1988) ("new motor vehicle acceptable to the consumer"); DEL. CODE ANN. tit. 6, § 5003(a) (1986) ("comparable new automobile"); MO. ANN. STAT. § 407.567(1) (Vernon 1988) ("comparable new vehicle acceptable to the consumer"); N.J. STAT. ANN. § 56:12-21a (West Supp. 1988) ("comparable new automobile").

157. IND. CODE § 24-5-13-11(a), -14 (1988).

158. See, e.g., H. GREENBERG, *supra* note 67, § 21.21; G. WALLACH, *THE LAW OF*



The lemon law eliminates another problem faced by courts under the U.C.C. by establishing a formula for computing the amount attributable to use following a demand for refund: the number of miles driven before the manufacturer's acceptance of the return divided by 100,000 times the total contract price.<sup>159</sup> Thus, if a lemon has been driven 5,000 miles and cost \$15,000, the manufacturer may deduct \$750 from the amount of the refund.<sup>160</sup> The establishment of this formula avoids the difficulty of determining the use value of a lemon, with its accompanying frustrations, and negates arguments by manufacturers, *e.g.*, that the use value should be the amount allowed by the I.R.S. to be deducted from one's income tax, or approximately twenty-one cents per mile.<sup>161</sup>

One troubling issue with respect to continued use after making a claim of substantial impairment is the possibility that a court may conclude that the impairment was not substantial because the buyer continued to drive the car.<sup>162</sup> Such a ruling would be contrary to the intent of the lemon law. Frequently, the buyer has no choice but to use the lemon rather than buy a new car. Addition of a provision which states that after notice to the manufacturer of an election between replacement or refund, continued use shall not be considered by the court in determining substantial impairment, would safeguard against such a ruling.<sup>163</sup>

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SALES UNDER THE UNIFORM COMMERCIAL CODE § 9.02[4][c] (1981); WHITE & SUMMERS, *supra* note 26, § 8-4. *Compare, e.g.*, *Gigandet v. Third Nat'l Bank*, 333 So.2d 557 (Ala. 1976) and *Charney v. Ocean Pontiac, Inc.*, 56 Mass. App. Dec. 104 (1975) (use nullified revocation) with *Jones v. Abriani*, 169 Ind. App. 556, 350 N.E.2d 635 (1976) and *McCullough v. Bill Swad Chrysler-Plymouth, Inc.*, 5 Ohio St. 3d 181, 449 N.E.2d 1289 (1983) (continued use justified; revocation effective).

159. IND. CODE § 24-5-13-11(b) (1988).

160.  $5,000/100,000 \times 15,000 = 750$ .

161. See FLA. STAT. ANN. § 681.104(2)(a) (West Supp. 1985); 1985 Miss. Laws 224, § 5(1). The Florida and Mississippi statutes permit an offset of twenty cents per mile. Virginia sets no specific allowance but does provide that it shall not exceed one-half of the amount allowed by the I.R.S. VA. CODE § 59.1-207.13 (Supp. 1984).

162. See *Gasque v. Mooers Motor Car Co.*, 227 Va. 154, 313 S.E.2d 384 (1984), which held, in part, that the buyer's use of his new car for 5,400 miles was evidence against substantial impairment despite seven unsuccessful repair attempts. *Cf. Koperski v. Husker Dodge, Inc.*, 208 Neb. 29, 302 N.W.2d 655 (1981), in which the court ruled that despite the numerous, serious defects in the automobile, the fact that it was resold by the reposessor for eighty-five percent of its purchase price supported the finding that the defects did not substantially impair its value under § 2-608 of the U.C.C. See *supra* note 66.

163. See *Virginia's Lemon Law*, *supra* note 9, at 424, in which the author comments on the failure of Virginia's lemon law to address the issue and on *Gasque v. Mooers Motor Car Co.*, 227 Va. 154, 313 S.E.2d 384 (1984).

2. *Attorney's Fees.*—The lemon law directs that the successful buyer's recovery of costs and expenses include attorney's fees—an item not mentioned in the U.C.C. and only available at the discretion of the court under Magnuson-Moss. Both the lemon law and Magnuson-Moss base the award of attorney's fees on time actually expended by the attorney and determined by the court to be reasonable, but the lemon law states that the buyer "is entitled to recover," a matter of right, whereas Magnuson-Moss provides that the buyer "may be allowed by the court to recover," which makes the recovery under Magnuson-Moss discretionary.<sup>164</sup>

Unfortunately, the provision for recovery of attorney's fees does not go far enough to give the aggrieved buyer the protection he or she truly needs. In pursuing lemon law rights, the buyer may require the services of an attorney in dealing with the manufacturer or dealer, especially in the informal dispute resolution proceeding. Undoubtedly, based on statistics alone, the manufacturer will have gone through many such proceedings.<sup>165</sup> The unrepresented buyer will be opposed by an expert, probably an attorney, with much experience in handling lemon claims. Unless the buyer has an attorney to represent him or her and to prepare necessary written submissions or to make an oral presentation, the informal procedure, no matter how fair and impartial it seems on its face, favors the manufacturer. Nevertheless, the language of the lemon law mandates an award of attorney's fees only if the buyer has succeeded in a court action. The statute distinguishes between "procedures" and "actions"<sup>166</sup> and authorizes the award of fees only to the buyer who "prevails" in an "action."<sup>167</sup> The time limit for bringing an action is tolled while the procedure is pending.<sup>168</sup> The successful buyer should be entitled to recover attorney's fees accrued from the date of the demand for refund or replacement, and the informal dispute resolution panel, if there is one, should be directed by the statute to award attorney's fees if the buyer's claim is meritorious.

Moreover, the statute directs the award of fees "reasonably incurred by the buyer for or in connection with the commencement and pros-

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164. Compare IND. CODE § 24-5-13-22 (1988) with 15 U.S.C. § 110(d)(2) (1982). See Pertschuk, *Consumer Automobile Problems*, 11 U.C.C. L.J. 145, 148 (1978).

165. In the first twenty months of lemon law applicability in Massachusetts, arbitration proceedings awarded \$3.2 million to unhappy buyers. See U.P.I. Wire Service, BC Cycle, Regional News, April 28, 1988 (NEXIS search, *supra* note 4). In New York, 1,384 cases went to arbitration in 1987. See U.P.I. Wire Service, AM Cycle, Regional News, March 21, 1988 (NEXIS search, *supra* note 4). See *supra* notes 4-8 and accompanying text.

166. Compare IND. CODE § 24-5-13-19 (1988), with *id.* §§ 24-5-13-21, -23.

167. See *id.* § 24-5-13-22.

168. *Id.* § 24-5-13-23(b).



ecution of the action.”<sup>169</sup> If this language is read narrowly, the court may exclude from the calculation the time spent in preparing for and participating in the informal dispute resolution procedure. The better reading would be to include all fees and costs incurred prior to the filing of suit as being incurred “in connection with the commencement.” A consumer attorney in Connecticut suggests that the award of a refund plus attorney’s fees and costs is not enough to motivate manufacturers to avoid litigation or to improve vehicle quality, but adds that a provision specifically authorizing punitive damages would go far toward achieving those goals.<sup>170</sup>

3. *Time Limitations.*—The buyer’s action against the manufacturer must be brought “within two (2) years following the date the buyer first reports the nonconformity to the manufacturer, its agent, or authorized dealer.”<sup>171</sup> This provision can result in buyer confusion. If the claim is based on a single nonconformity which the manufacturer has failed to remedy after four attempts, the two-year period begins to run from the first complaint about that particular nonconformity, which can be in the first week of ownership without regard to the date of the fourth unsuccessful attempt. The fourth attempt may even take place after expiration of the eighteen-month/18,000-mile term of protection.<sup>172</sup> A buyer whose lemon undergoes four engine replacements at six-month intervals beginning the second week of ownership will have just under six months remaining after the last replacement to bring suit.

If the claim is based on a series of nonconformities which require thirty days or more in the shop, the period begins to run when the first complaint for warranty work is made to the dealer, usually, but not necessarily, quite early in the ownership period. If complaint is made within the first week, as in many of the reported cases,<sup>173</sup> the lemon law claim will be barred approximately two years after the buyer took delivery or six months after the end of the term of protection. A more equitable provision would be to start the running of time from the event which triggers lemon law rights, either the fourth unsuccessful attempt or the thirtieth day of shop time.

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169. *Id.* § 24-5-13-22.

170. See Note, *The Connecticut Lemon Law*, 5 U. BRIDGEPORT L. REV. 175, 201 (1983).

171. IND. CODE § 24-5-13-23(a) (1988).

172. See *id.* § 24-5-13-8 (requiring the dealer to make repairs of a nonconformity reported to the dealer or manufacturer within the term of protection “even if the repairs are made after expiration of the term of protection”).

173. See, e.g., *Zabriskie Chevrolet, Inc. v. Smith*, 99 N.J. Super. 441, 240 A.2d 195 (1968); *Rozmus v. Thompson’s Lincoln-Mercury, Inc.*, 209 Pa. Super. 120, 224 A.2d 782 (1966).

Another problem with the two-year period is that it is inconsistent with the four-year limitation established by the U.C.C.<sup>174</sup> Although the Code period of limitation on a warranty action begins to run from the date of delivery, if the express warranty extends the seller's obligation, it may also extend the limitation period.<sup>175</sup> The recipient of a one year warranty may have four years from the date the nonconformity is or should have been discovered, which could be the last week of the warranty period, thereby giving her almost five years from the date of delivery and four years from the date of complaint. One saving feature of the Lemon law is that if the buyer commences an approved informal dispute resolution procedure, the two year period is tolled during the time that procedure is pending.<sup>176</sup>

### *G. Restrictions on Resale of Lemons*

The lemon law provides that if a vehicle has been returned to the manufacturer under its provisions or any other judgment, award or agreement in Indiana or elsewhere, the manufacturer must disclose "that the vehicle was returned . . . because of a nonconformity not cured within a reasonable time as required by Indiana law" and must provide the same warranty as provided to the original buyer for a term of at least twelve months or 12,000 miles.<sup>177</sup> It is not clear whether the twelve months/12,000 miles of protection is merely express warranty protection, failure of which must be remedied pursuant to the U.C.C., or lemon law protection, which may be remedied under the lemon law with refund or replacement as the ultimate solution.

Should the manufacturer not give the additional warranty and disclose that the car was a returned lemon, "the motor vehicle may not be resold in Indiana . . . ." <sup>178</sup> The lemon law does not state what happens if a manufacturer fails to comply with this mandate. It is reasonable to assume that an aggrieved second buyer of a lemon could undo the transaction, get her money back, and recover consequential and possibly punitive damages. Unfortunately, the experience in other

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174. See U.C.C. § 2-725.

175. U.C.C. § 2-725(2) provides:

A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

176. IND. CODE § 24-5-13-23(b) (1988).

177. *Id.* § 24-5-13-17.

178. *Id.*



states with respect to lemon resales has been mixed, and some state attorneys general have been required to pursue manufacturers who have failed to comply with the requirement that a subsequent buyer be told of the car's history.<sup>179</sup>

The means and the language by which the prior history of the car must be disclosed is not specified. If this information is buried in a warranty book or contained on the front or back of a long agreement of sale, its import is not likely to be brought home to a prospective buyer. One critic has suggested the use of a sticker on the car itself,<sup>180</sup> a suggestion which has much to commend it. Some buyers may be unwilling to purchase, at any price, a car known to be a reconstituted lemon.<sup>181</sup> Others may be willing to buy the car at a substantially reduced price or perhaps at the prevailing market price for similar used cars because of the additional warranty protection mandated by the lemon law. But the character and prior history of the car must be disclosed clearly and so it can be understood.

In view of the past history of manufacturers with respect to lemon resales, however, without some provision by which the state can verify

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179. See, e.g., N.Y. Times, Sept. 30, 1988, at B2, col. 1, in which it was reported that 400 lemons repurchased by Chrysler Corp. had been resold to buyers without informing them of the lemons' histories and without reporting the repurchases to the state division of motor vehicles, as required by the New York lemon law. See N.Y. GEN. BUS. LAW § 198-a(c)(2)(McKinney 1985). Describing Chrysler's conduct as "one of the more flagrant violations of law I've ever seen," Attorney General Abrams obtained a settlement pursuant to which Chrysler would either buy back the cars or pay to each buyer \$1,000, give a further twelve-month/12,000-mile warranty, and pay for any prior repairs. The total cost could reach \$2,000,000.

In Connecticut, the state and General Motors reached an agreement which resolved a complaint that G.M. was reselling lemons without informing buyers of the cars' past records. Part of the agreement was that G.M. would report to the Connecticut Department of Motor Vehicles the vehicle identification numbers and all other pertinent information about returned lemons. Similar agreements were expected with Ford, Toyota, and other manufacturers. See U.P.I. Wire Service, Regional News, BC Cycle, July 6, 1988 (NEXIS search, *supra* note 4). In 1987, Connecticut amended its lemon law to add a requirement that the manufacturer who accepts the return of a motor vehicle due to nonconformity or defect must notify the department of motor vehicles and provide relevant information. See CONN. GEN. STAT. ANN. § 42-179(g) (West Supp. 1988).

Connecticut was also required to file suit against Chrysler Corp. and Ford Motor Co. for allegedly failing to provide the required information to the department of motor vehicles. See U.P.I. Wire Service, Regional News, BC Cycle, March 2, 1988 (NEXIS search, *supra* note 4).

180. See Vogel, *supra* note 2, at 643.

181. In the N.Y. Times story discussed above, see *supra* note 179, after the manufacturer offered to take back a particular buyer's lemon, the buyer took it to an authorized dealer who resold it four months later. A manufacturer's representative acknowledged that the car had not been repaired between the time of the return and the time of the resale.

and enforce compliance, the simple direction that buyers be informed of a lemon's prior history may well prove to be totally ineffective. Both Connecticut and New York provide that in addition to notifying the buyer, the manufacturer must also report specific information to the department of motor vehicles.<sup>182</sup> In addition, New York requires in another statute that the following language, in ten point, capital type, be given to the buyer and be printed conspicuously on the car's title:

IMPORTANT: THIS VEHICLE WAS RETURNED TO THE MANUFACTURER OR DEALER BECAUSE IT DID NOT CONFORM TO ITS WARRANTY AND THE DEFECT OR CONDITION WAS NOT FIXED WITHIN A REASONABLE TIME AS PROVIDED BY NEW YORK LAW.<sup>183</sup>

Short of requiring the manufacturer or dealer to paste a large, yellow lemon on the windshield of the returned automobile before resale, requirements such as these should be incorporated into the Indiana lemon law.

#### *H. Inducements to and Sanctions Against the Manufacturer*

Other than permitting a buyer to go directly to court in order to obtain a refund or replacement and prohibiting the resale of reconstituted lemons, the lemon law contains no sanctions against a manufacturer who fails to comply with its requirements or sanctions which would induce such compliance. The remedy of a refund or replacement, while somewhat annoying to a manufacturer, is certainly not of sufficient weight to induce a manufacturer not to delay giving relief to the lemon buyer. The award of attorney's fees under Magnuson-Moss and punitive damages in appropriate cases under Indiana law have done little to affect the conduct of manufacturers over the past decade or so. In the 1989 model year, some manufacturers appear to be offering warranties of longer duration, but a warranty is truly only as good as the willingness of the manufacturer to stand behind it if the car is a lemon. That willingness, in past years, has been questionable at best. Otherwise, there would have been no incentive for legislatures to enact lemon laws.

Other states have met this problem in various ways. Some authorize an award of treble damages against a manufacturer who fails to comply

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182. See CONN. GEN. STAT. ANN. § 42-179(g) (West Supp. 1988); N.Y. GEN. BUS. LAW § 198-a(c)(2) (McKinney 1985).

183. N.Y. VEH. AND TRAF. LAW § 417-a (McKinney Supp. 1988).



with the remedies mandated by the applicable lemon law.<sup>184</sup> Others provide that the manufacturer's failure to comply with the lemon law shall constitute an unfair or deceptive trade practice.<sup>185</sup> The Minnesota state attorney general brought suit to prevent further sale of Mazda and Isuzu vehicles in his state because the two companies failed to comply with the Minnesota lemon law requirement relating to informal dispute resolution procedures.<sup>186</sup> The two companies subsequently agreed to comply.<sup>187</sup>

With nothing more to prod manufacturers into compliance than already existing remedies, enactment of the lemon law could prove to have been nothing more than an empty gesture.

The lemon law creates no rights against and imposes no obligations upon the dealer, whether asserted by the buyer or the manufacturer.<sup>188</sup> Any claim the buyer may have against the dealer must be brought under the U.C.C. and the Magnuson-Moss Act. Therefore, in asserting his or her rights against both the dealer and the manufacturer, the buyer must take great care to satisfy the requirements of each statute with respect to such matters as notice, time limitations, and so forth. Failure to pay close attention to the different requirements may easily result in a loss of otherwise available rights.

Whether the manufacturer has a claim against the dealer for the dealer's inadequate repair work is irrelevant to the buyer's lemon law claim. The resolution of any problems which the manufacturer has with the manner in which the dealer performs its warranty service obligations will be based on the terms of the franchise agreement between the manufacturer and the dealer, not on the lemon law.

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184. See, e.g., IDAHO CODE § 48-908 (Supp. 1988) (treble the full purchase price including collateral charges less an allowance for use if the buyer successfully pursues a court action because the manufacturer refused to replace or refund); MINN. STAT. ANN. § 325F.665 (West Supp. 1988) ("three times the actual damages sustained, together with costs and disbursements, including reasonable attorney's fees" if either party, in bad faith, asserts a frivolous claim or defense); VA. CODE § 59.1-207.16 (Supp. 1988) (if the buyer must sue because the manufacturer fails to comply with the arbitration award, the court may triple the value of the award, plus award equitable relief and attorney's fees).

185. See, e.g., CONN. GEN. STAT. ANN. § 42-184 (West 1987) (violation of the provisions of the lemon law "shall be deemed an unfair or deceptive trade practice"); ME. REV. STAT. ANN. tit. 10, § 1166 (Supp. 1987) (violation of lemon law "shall be considered prima facie evidence of an unfair or deceptive trade practice").

186. See U.P.I. Wire Service, BC Cycle, Regional News, April 1, 1988 (NEXIS search, *supra* note 4).

187. See *id.*, July 13, 1988.

188. IND. CODE § 24-5-13-24 (1988):

Nothing in this chapter imposes any liability on a dealer or creates a cause of action by a consumer against a dealer, and a manufacturer may not, directly or indirectly, expose any franchised dealer to liability under this chapter.

### III. CONCLUSION

If all the lemon law achieves is to make the public more aware of automobile buyers' rights and to give buyers an added incentive to insist on receiving what manufacturers promise—safe, reliable, defect free automobiles—then enactment of the lemon law will have achieved some of its goals. The reports from other jurisdictions indicate that some of those goals have been achieved.<sup>189</sup> Nevertheless, legislators in a number of states have concluded that their respective lemon laws have not been working well enough and should be made tougher.<sup>190</sup>

Indiana's lemon law has dealt with some of the problems of other state lemon laws, but standing alone, it gives to buyers few rights which they did not already have, in some form, under the combined forces of the Uniform Commercial Code and the Magnuson-Moss Act. It does attempt to clarify those rights and to put them in one place so that the procedures to be followed and the relief available to aggrieved lemon owners are reasonably straightforward and understandable. The problems and ambiguities discussed in the body of this article will have to be dealt with by the courts and, in some instances, by the legislature as well.

Whether the lemon law will prove to be a success depends in large part both on the effectiveness of any alternative dispute resolution mechanism ultimately approved by the attorney general, and on whether the courts interpret the law liberally, in accord with the spirit in which it was enacted, or restrictively, so as to limit, rather than expand, buyers' rights. Despite its shortcomings, the lemon law is a step in the direction of giving automobile buyers an offensive weapon with which to attack large manufacturers who hide behind stone walls of non-cooperation and delay. Whether the lemon law will prove to be the real thing for sweetening the lemon or merely a weak imitation sweetener remains to be seen. The likelihood is that time will prove it to be the real thing, but not yet effective enough to eliminate all of the sour aftertaste.

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189. The N.Y. Attorney General has reported that manufacturers have paid out \$15.5 million under the New York Lemon Law and that of the 1,384 cases which went to mandatory arbitration, 921 resulted in decisions favoring the buyers. An additional 275 were settled without arbitration. U.P.I. Wire Service, AM Cycle, Regional News, March 21, 1988 (NEXIS search, *supra* note 4). During the first twenty months of a lemon law in Massachusetts, service from dealers improved and manufacturers refunded \$3.2 million to car buyers. See U.P.I. Wire Service, BC Cycle, Regional News, April 28, 1988 (NEXIS search, *supra* note 4).

190. See U.P.I. Wire Service, BC Cycle, Regional News, May 16, 1988 (NEXIS search, *supra* note 4) (N.J. senate passes amendments to make N.J. lemon law strongest in the country); *id.*, AM Cycle, Feb. 4, 1988 (Florida's attorney general announced proposal stiffening lemon law to which consumer groups, dealers and manufacturers agreed).



Several steps should be taken by the legislature to strengthen the Indiana lemon law:

1. Clarify the requirement of nonconformity to reflect that replacement or refund is only available if the problem is substantial, whether the nonconformity is a defect or condition which impairs or is a failure to conform to warranty.

2. Impose penalties on manufacturers who fail to comply with the requirements of the lemon law with respect to initial repairs and final replacement or refund.

3. Require manufacturers to disclose to buyers, in conspicuous, easy to understand language, their rights under the lemon law and impose penalties on manufacturers who fail to do so.

4. Impose severe penalties on manufacturers who expressly or impliedly permit dealers to resell returned lemons without disclosing their prior histories to prospective buyers in conspicuous, easy to understand language.

5. Require that all manufacturers' disclosures be stated in plain English on a tag conspicuously attached to the vehicle's windshield and removable only by the buyer.

6. Impose penalties on any party who asserts a claim or defense in bad faith.

7. Change coverage to include all vehicles registered in Indiana after the effective date of the lemon law, whether or not the vehicle was purchased in Indiana.

8. Reduce the number of unsuccessful attempts to repair a single nonconformity to either two or three and reduce the number of unsuccessful attempts to repair a safety-related nonconformity to one or two.

9. Clarify the thirty-days-out-of-service requirement to state that the cumulation of time will be calculated for any combination of nonconformities requiring service.

10. Clarify and redraft the notice requirements to impose upon the servicing dealer the obligation to notify the manufacturer of both the vehicle's problems and of the election of the buyer between refund or replacement.

11. Provide for recovery of attorney's fees by a buyer who is successful in an alternative dispute resolution proceeding as well as in litigation.

12. Provide that a cause of action under the lemon law accrues on the thirtieth day of service for nonconformities within the term of protection or upon the fourth unsuccessful attempt to repair a nonconformity.

13. Finally, if one of the reasons for the lemon law is to give the buyer relief in an informal setting without the expense and delay

of litigation, the lemon law should require manufacturers to establish certifiable dispute resolution mechanisms. They already have some mechanisms in place because of the Magnuson-Moss Act. Those mechanisms need only be refined to comply with federal regulations. Should they fail to do so, perhaps the legislature should establish a state-run system, as has been done in a number of other jurisdictions.





# Developments in Federal Civil Practice Affecting Indiana Practitioners: Survey of Supreme Court, Seventh Circuit, and Indiana District Court Opinions

JOHN R. MALEY\*

## INTRODUCTION

Indiana practitioners attempting to discern the trends of the federal courts in which they practice have traditionally encountered a common problem, namely, a lack of any organized, succinct evaluation of the more significant decisions rendered by the local federal courts. The national treatises on federal civil practice such as *Moore's*<sup>1</sup> and *Wright and Miller*<sup>2</sup> are certainly excellent research tools, but they offer the local attorney only sparse insight into the holdings of the Seventh Circuit Court of Appeals and the Indiana District Courts. Because the thirteen federal circuits often differ in their specific interpretation and application of the rules governing federal practice, and because the Supreme Court rarely steps in to clarify such areas, it is important for the Indiana federal practitioner to have some source to consult on local federal practice.<sup>3</sup> This Article, as the first of an annual section of the Survey Issue devoted to federal civil practice and procedure,<sup>4</sup> attempts to help fill this void.

In doing so, this Article will concentrate on procedural and jurisdictional matters addressed by the United States Supreme Court, the Seventh Circuit Court of Appeals, and the Indiana District Courts. Primary attention will be given to newly developing trends or unusual holdings that have a high propensity to affect Indiana practitioners. No

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\* Law Clerk to the Honorable Larry J. McKinney, United States District Court for the Southern District of Indiana. B.A., University of Notre Dame, 1985; J.D. (*summa cum laude*), Indiana University School of Law—Indianapolis, 1988. The views expressed are solely those of the author. The author is grateful to Sheryl B. McGrath for her comments on an early draft.

1. See J. MOORE, W. TAGGART & J. WICKER, *MOORE'S FEDERAL PRACTICE* (2d ed. 1985).

2. See C. WRIGHT, A. MILLER & M. KANE, *FEDERAL PRACTICE AND PROCEDURE* (2d ed. 1983) [hereinafter *WRIGHT & MILLER*]. Also helpful is *WEST'S FEDERAL PRACTICE MANUAL* (2d ed. 1970), as well as *WEST'S FEDERAL PRACTICE DIGEST* (3d ed. 1984).

3. One useful research tool that Indiana practitioners might not be aware of is the *SEVENTH CIRCUIT DIGEST*. This looseleaf binder, which is updated monthly by the Staff Attorneys of the Seventh Circuit Court of Appeals, is available on reserve at each of the federal court libraries of the Indiana district courts.

4. Criminal procedure will not be discussed so that more attention can be given to civil matters that likely affect a broader range of practitioners.



attempt will be made to discuss substantive, non-procedural matters as such areas are better left to other forums.

During the Survey period,<sup>5</sup> several important developments occurred in the area of summary judgment practice. On a single day in June of 1986, the United States Supreme Court issued two opinions that signaled a sudden and dramatic shift in philosophy towards this pre-trial procedure. In one case, *Celotex Corp. v. Catrett*,<sup>6</sup> the Court clarified the moving party's burdens of production and persuasion, an issue that had been the source of some consternation in the lower courts.<sup>7</sup> In an unrelated case, *Anderson v. Liberty Lobby, Inc.*,<sup>8</sup> the Court held that the burden of proof to be used at the trial stage, *i.e.*, clear and convincing evidence in a public figure defamation case, should be applied in ruling on the pre-trial summary judgment motion.<sup>9</sup> Perhaps more important than the specific holdings, the majority in each case used powerful language welcoming the lower courts to more readily dispose of cases prior to trial by way of summary judgment.

Although the cases were immediately praised by the defense bar and feared by plaintiff's lawyers, the true impact of the decisions was unclear because the Court remanded each case for application of the new standards. Thus, despite the attempt to clarify this important area, the lower courts were once again left with the task of trying to interpret and comply with the Supreme Court's directives.<sup>10</sup> In order to discern how

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5. As this is the first such Survey Article on federal practice, the survey period will be longer than with other articles, covering developments from 1986 through August, 1988.

6. 477 U.S. 317 (1986).

7. Compare *Catrett v. Johns-Manville Sales Corp.*, 756 F.2d 181 (D.C. Cir. 1985) with *In re Japanese Elec. Prods. Antitrust Litig.*, 723 F.2d 238 (3d Cir. 1983).

8. 477 U.S. 242 (1986).

9. During the same term, the Supreme Court handed down a third case signaling a shift in attitude towards summary judgment. In *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), the Court "first began its retooling of summary judgment practice." Childress, *A New Era for Summary Judgments: Recent Shifts at the Supreme Court*, 116 F.R.D. 183, 185 (1987). While *Matsushita* is an important summary judgment decision, its greatest impact will likely be on antitrust cases. This Article will thus only refer to *Matsushita* in passing. For an example of the effect of *Matsushita* on summary judgment practice in antitrust cases, see *Indiana Grocery Co. v. Super Valu Stores, Inc.*, 648 F. Supp. 561 (S.D. Ind. 1988).

10. As one commentator noted,

Although the Court expounded the methods for reviewing a summary judgment motion in *Celotex* and *Anderson*, it did not apply these methods to the facts of each case. Instead, the Court remanded both cases for application of the new standards. The dissenters criticized this failure to apply theory to fact and warned that the Court's decisions could cause trial and appellate level confusion. Therefore, an unclear issue is whether the lower courts are correctly interpreting the *Celotex* and *Anderson* standards.

Comment, *Federal Summary Judgment: The "New" Workhorse for an Overburdened Federal Court System*, 20 U.C. DAVIS L. REV. 955, 968 (1987).

the local United States Court of Appeals is responding to the Supreme Court's new attitude towards summary judgment, this Article will evaluate some of the more significant Seventh Circuit summary judgment decisions rendered since *Celotex* and *Anderson*. Part I of the Article will address the specific holding of *Celotex* and its reception in the Seventh Circuit.<sup>11</sup> It will similarly discuss the decision in *Anderson* and evaluate its specific impact on the Seventh Circuit.<sup>12</sup> Part II will then look more generally at how the Seventh Circuit and Indiana District Courts have responded to the drastic shift in attitude towards summary judgment reflected in *Celotex* and *Anderson*.<sup>13</sup> Finally, Part III will discuss how the decisions could influence Indiana civil procedure, and will argue that the Indiana courts should be wary of rushing to adopt either the new attitude toward federal summary judgment or the specific holding of *Anderson*.<sup>14</sup>

The Article will then discuss an unusual and important issue concerning the effect of loan receipt agreements on federal diversity jurisdiction. In a recent case decided by an Indiana District Court,<sup>15</sup> a negligence and products liability action against several in-state and out-of-state defendants was held properly removed from state court to federal court because of the existence of a loan receipt agreement with the non-diverse Indiana defendants. The court ruled that the loan receipt agreement, under which the Indiana defendants "loaned" funds to the plaintiff pending the outcome of the litigation, destroyed any hostility between the Indiana defendants and the Indiana plaintiff. Accordingly, the court held that the non-diverse Indiana defendants were properly realigned as plaintiffs for purposes of determining the existence of diversity jurisdiction, thereby creating complete diversity between the Indiana plaintiff and the other out-of-state defendants. Part IV of this Article will discuss this unique jurisdictional issue, pointing out how both plaintiff and defendant may be able to benefit from its holding.<sup>16</sup>

## I. THE SPECIFIC PROCEDURAL HOLDINGS OF THE SUMMARY JUDGMENT DECISIONS AND THEIR RECEPTION IN THE SEVENTH CIRCUIT

### A. *Celotex Corp. v. Catrett*:<sup>17</sup> *Clarifying the Movant's Burden*

In *Celotex*, the plaintiff brought a wrongful death action alleging that her husband's death resulted from exposure to asbestos products

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11. See *infra* text accompanying notes 17-60.

12. See *infra* text accompanying notes 61-114.

13. See *infra* text accompanying notes 115-32.

14. See *infra* text accompanying notes 133-54.

15. *O'Connor v. Sears, Roebuck and Co.*, No. TH 85-261-C (S.D. Ind. Apr. 10, 1986)(order denying motion to remand action to state court). See *infra* app. for text of order, at p. 139-49.

16. See *infra* text accompanying notes 155-93.

17. 477 U.S. 317 (1986).



manufactured by fifteen named corporations, one of them being the Celotex Corporation. Pursuant to Rule 56 of the Federal Rules of Civil Procedure, defendant Celotex later filed a motion for summary judgment arguing that the plaintiff had “‘failed to produce evidence that any [Celotex] product . . . was the proximate cause of the injuries alleged . . . .’ In particular, [Celotex] noted that [plaintiff] had failed to identify, in answering interrogatories specifically requesting such information, any witnesses who could testify about the decedent’s exposure to [Celotex’s] asbestos products.”<sup>18</sup> Thus, rather than affirmatively coming forward with evidence tending to negate or refute the plaintiff’s claim, Celotex simply attempted to demonstrate to the court the failure of an essential element of the plaintiff’s claim (here exposure to the defendant’s product).

In response to the motion for summary judgment, Mrs. Catrett “‘produced three documents which she claimed ‘demonstrate that there is a genuine material factual dispute’ as to whether the decedent had ever been exposed to [Celotex’s] asbestos products.’”<sup>19</sup> The documents, which would arguably have been inadmissible at trial under hearsay rules, included a transcript of a deposition of the decedent, a letter from an official of one of the decedent’s former employers, and a letter from an insurance company to the plaintiff’s attorney. All three documents tended to establish that Mr. Catrett had been exposed to Celotex’s asbestos products during 1970-1971. The District Court for the District of Columbia, however, granted defendant’s motion for summary judgment on the grounds that there was no showing the decedent was ever exposed to Celotex asbestos products.<sup>20</sup>

On appeal to the District of Columbia Circuit Court of Appeals, a divided panel reversed the entry of summary judgment.<sup>21</sup> The majority ruled that Celotex’s Rule 56 motion was rendered “‘fatally defective’ by the fact that [Celotex] ‘made no effort to adduce *any* evidence, in the form of affidavits or otherwise, to support its motion.’”<sup>22</sup> Under the reasoning of the D.C. Circuit, “the party opposing the motion for summary judgment bears the burden of responding *only after* the moving party has met its burden of coming forward with proof of the absence of any genuine issues of material fact.”<sup>23</sup> Because the Court of Appeals determined that the movant had not yet satisfied its burden of proof, it was, of course, unnecessary for the court to even address the sufficiency of Mrs. Catrett’s response. Thus, the court did not need to consider

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18. *Id.* at 319-20.

19. *Id.* at 320.

20. *Id.*

21. *Catrett v. Johns-Manville Sales Corp.*, 756 F.2d 181 (D.C. Cir. 1985).

22. *Celotex*, 477 U.S. at 321 (quoting *Catrett*, 756 F.2d at 184) (emphasis in original).

23. *Catrett*, 756 F.2d at 184 (emphasis in original).

Celotex's contention that the documents produced by plaintiff should not be accorded any weight because they would arguably be inadmissible at trial, a separate issue in and of itself.<sup>24</sup>

Judge Bork dissented, arguing that the court was mistaken "in supposing that a party seeking summary judgment must always make an affirmative evidentiary showing, even in cases where there is not a triable, factual dispute."<sup>25</sup> In Judge Bork's view, the Court of Appeals' majority opinion interpreted Rule 56 to mean that the moving party had to "prove a negative"<sup>26</sup> by somehow bringing forth affirmative evidence showing the absence of an essential element of the plaintiff's *prima facie* case.<sup>27</sup>

In order to resolve a split among the circuits concerning the movant's burden of production,<sup>28</sup> the Supreme Court granted certiorari and reversed the decision of the Court of Appeals. In a 5-4 decision which produced one concurring opinion and two separate dissents,<sup>29</sup> the majority ruled that the Court of Appeals had misread the standard for summary judgment set forth in the federal rules. Writing for the majority, Justice Rehnquist explained that

the plain language of Rule 56(c) *mandates* the entry of summary judgment, after adequate time for discovery and upon motion,

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24. Rule 56(e) of the Federal Rules of Civil Procedure provides that "Supporting and opposing affidavits shall . . . set forth such facts as would be admissible in evidence . . . ." Despite this language, though, the courts do not require the evidence submitted at summary judgment to be in perfect trial form. For instance, Judge Barker recently noted that "the rule does not require an unequivocal conclusion that the evidence will be admissible at trial as a condition precedent to its consideration on a summary judgment motion. . . ." *Reed v. Ford Motor Co.*, 679 F. Supp. 873, 874 (S.D. Ind. 1988). A court "will not exclude evidence at this stage on grounds of hearsay, irrelevance, or undue prejudice. The court must make those types of determination at trial because '[a]dmissibility of testimony sometimes depends upon the form in which it is offered, the background which is laid for it, and perhaps on other factors as well.'" *Id.* at 875 (citation omitted).

25. *Catrett*, 756 F.2d at 188 (Bork, J., dissenting). Judge Bork's excellent analysis was essentially adopted later by the Supreme Court majority.

26. One commentator coined this phrase, writing, "[T]he Court of Appeals required the defendant to 'prove a negative,' by showing the absence of any genuine issue of material fact, in order to sustain its motion." Kennedy, *Federal Summary Judgment: Reconciling Celotex v. Catrett with Adickes v. Kress and the Evidentiary Problems Under Rule 56*, 6 REV. LITIG. 227, 238 (1987).

27. For the sake of simplicity, this Article will consistently use the "defendant" as the movant for summary judgment. The same principles, of course, would apply in those instances where the plaintiff is moving for summary judgment on an affirmative defense or other issue on which the defendant bears the burden of proof.

28. See *supra* note 7.

29. *Celotex*, 477 U.S. 317. Justice Rehnquist wrote for the majority and was joined by Justices Marshall, O'Connor, Powell, and White. Justice White authored a concurring opinion. Justice Brennan filed a dissenting opinion in which Chief Justice Burger and Justice Blackmun joined. Justice Stevens also filed a dissenting opinion.



against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial.<sup>30</sup>

In such a situation, the nonmoving party has simply failed to make a sufficient showing on an essential element of the *prima facie* case, and the movant's duty is merely to point this out to the court.

"Of course," the majority explained, "a party seeking summary judgment always bears the initial responsibility of informing the district court of the basis for its motion. . . ." <sup>31</sup> The moving party does this by "identifying those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any,' which it believes demonstrate the absence of any genuine issue of material fact. But," the Court continued, "unlike the Court of Appeals, we find no express or implied requirement in Rule 56 that the moving party support its motion with affidavits or other similar materials *negating* the opponent's claim."<sup>32</sup> Rather, under *Celotex* it is enough for the moving party to simply demonstrate to the district court that the moving party raises "factually unsupported claims or defenses" such that the burden then shifts to the non-movant to demonstrate the existence of a genuine issue of material fact.<sup>33</sup> Once the moving party has satisfied this burden, the non-movant must then "go beyond the pleadings and by her own affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.'"<sup>34</sup>

Having decided that a moving party may satisfy its burden by merely demonstrating that an essential element of the non-movant's claim or defense is devoid of proof, the Court reversed and remanded the case to the Court of Appeals to determine the adequacy of the non-movant's response to the defendant's motion.<sup>35</sup>

Restated, then, the precise holding of *Celotex* is that a moving party need not initially bring forth its own independent evidence negating the non-moving party's claim or defense; rather, the movant satisfies its initial burden of production by demonstrating to the district court that there is a complete failure of evidence on an essential element. The moving party accomplishes this by pointing out that the record to date, which

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30. *Id.* at 322 (emphasis added).

31. *Id.* at 323.

32. *Id.* (emphasis in original).

33. *Id.* at 323-24.

34. *Celotex*, 477 U.S. at 324.

35. Justice Brennan, however, noted in his dissent that it was not immediately apparent what the Court of Appeals was to do on remand. *Id.* at 329 n.1 (Brennan, J., dissenting).

may include pleadings, discovery responses, and affidavits, is devoid of evidence tending to prove an element of the non-movant's claim or defense. If the moving party has not fully discharged this initial burden, its motion for summary judgment must be denied.<sup>36</sup> If the movant satisfies this burden, the non-movant must then go beyond the pleadings and demonstrate the existence of a genuine issue for trial.

Although this holding would, at first glance, seem to be a natural interpretation of Rule 56 that would merit little comment,<sup>37</sup> the awkward posture of the case and the debate raised by the concurring and dissenting opinions left the lower courts with a somewhat muddled picture of the *Celotex* standard. Accordingly, it is important to analyze several decisions from the Seventh Circuit discussing *Celotex* to guide the Indiana practitioner in this area.

### B. Application of *Celotex* in the Seventh Circuit

Although the Seventh Circuit Court of Appeals and the local district courts have cited *Celotex* repeatedly in the short time since the Supreme Court clarified the parties' burdens of production,<sup>38</sup> only a few cases serve to illustrate the application of the *Celotex* burden-shifting standard. The greater effect of *Celotex*, as discussed in detail in Part II of this Article, has been an apparent warming towards disposition of cases by summary judgment.<sup>39</sup> Nonetheless, three cases from the survey period serve to illustrate the burden of production principles that were clarified by the Supreme Court.

The 1987 case of *Nur v. Blake Development Corp.*,<sup>40</sup> decided by Judge Miller of the Northern District of Indiana, serves as a prime example of how a movant may satisfy its burden of production without having to "prove a negative." In *Nur*, two non-minorities brought suit under the Fair Housing Act and the Civil Rights Act alleging that Blake Development engaged in discriminatory housing practices.<sup>41</sup> These non-

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36. Justice Brennan's dissent serves as an excellent analysis of these principles. See 477 U.S. at 329-37 (Brennan, J., dissenting).

37. Justice Stevens called the majority opinion an "abstract exercise in Rule construction," *Id.* at 339 (Stevens, J., dissenting), while Justice Brennan disagreed not with the majority's pronouncements but with "the application of these principles to the facts of this case." *Id.* at 334 (Brennan, J., dissenting). See also *infra* text accompanying notes 63-65.

38. Through August, 1988, the Seventh Circuit has cited *Celotex* in 22 reported appeals from district court entries of summary judgment. See *infra* text accompanying notes 115-16.

39. See *infra* text accompanying notes 115-32.

40. 655 F. Supp. 158 (N.D. Ind. 1987).

41. *Id.* at 160-61.



minority plaintiffs, however, did not allege that such practices were directed against them; rather, they complained of "subjective pain and suffering upon discovering that other members of their own race were engaging in the prohibited discriminatory conduct . . . ." <sup>42</sup> After taking the depositions of the non-minority plaintiffs, the defense moved for summary judgment contending that the plaintiffs lacked standing to bring such an action. In essence, the thrust of the defense motion was that, even assuming the existence of discriminatory practices, the plaintiffs did not receive a direct, palpable injury from such action. Because of the difficulty of coming forward with affirmative independent evidence tending to disprove this negative, the defense merely relied on the depositions of the plaintiffs to show the failure of an essential element of the claim. <sup>43</sup>

In granting summary judgment for the defense, Judge Miller first cited to *Celotex* and discussed the standards under Rule 56, writing, "In a summary judgment motion, the movant must first demonstrate, by way of the pleadings, depositions, answers to interrogatories, admissions on file, and affidavits, if any, that (1) no genuine issues of material fact exist for trial, and (2) the movant is entitled to judgment as a matter of law." <sup>44</sup> Then, if the non-movant

would bear the burden of proof at trial on the matter that forms the basis of the summary judgment motion, the burden of proof shifts to the [non-movant] if the movant makes its initial showing, and the [non-movant] must come forth and produce affidavits, depositions, or other admissible documentation to show what facts are actually in dispute. <sup>45</sup>

The court then ruled that "defendants had met their initial burden under *Celotex Corp. v. Catrett*." <sup>46</sup> Accordingly, the burden then shifted to the plaintiffs "to produce proper documentary evidence to support their contentions." <sup>47</sup> Plaintiffs, by relying on "the mere allegations of their complaint" and "conclusory statements in their affidavits," <sup>48</sup> failed to meet this burden. Thus, summary judgment was proper under *Celotex* because the defense had adequately demonstrated the failure of evidence on an essential element of the plaintiffs' claim, and the plaintiffs then failed to come forth with any proof of that element.

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42. *Id.* at 161.

43. *Id.*

44. *Id.* at 159 (citations omitted).

45. *Id.* (citations omitted). Note again that the admissibility requirement is looser than this language might suggest. See *supra* note 24.

46. 655 F. Supp. at 162.

47. *Id.* (citations omitted).

48. *Id.* (citations omitted).

Similarly, the bankruptcy case of *In re Klein*<sup>49</sup> illustrates proper application of the *Celotex* principles. In *Klein*, the creditor sought a declaratory judgment that it possessed a valid security interest in collateral which the Chapter 11 debtor had pledged. The parties did not dispute the validity of the various contracts involved, but rather disagreed as to their interpretation. After discovery, the creditor moved for summary judgment relying solely on the documents already in the record.

In granting the creditor's motion, the court discussed at some length the importance of the *Celotex* holding and how the case had been misread by the trustee. In response to the creditor's motion, the trustee had contended that "the Supreme Court [in *Celotex*] has interpreted Fed. R. Civ. P. 56 as imposing upon the moving party the burden of presenting 'evidence (which is) not merely colorable, but which is *significantly probative* and which *precludes the rendering of a contrary verdict*.'" <sup>50</sup> The *Klein* court, however, rejected this interpretation, explaining instead that "under *Celotex*, all Rule 56 requires [the movant] to do is 'show'—i.e., 'point out'—to this Court that there is no genuine issue of material fact."<sup>51</sup> The court found that the creditor had met this burden, and therefore, "the burden of proof shift[ed] to the adverse party . . . to set forth 'specific facts showing that there is a genuine issue for trial.'"<sup>52</sup> The court found the trustee had not met this burden and accordingly entered summary judgment for the creditor.

To the same effect is *Valentine v. Joliet Township High School District No. 204*,<sup>53</sup> in which the Seventh Circuit expounded the proper application of the *Celotex* burden-shifting principles. In *Valentine*, a dismissed high school guidance counselor appealed the district court's entry of summary judgment on his Section 1983 suit that sought reinstatement and damages.<sup>54</sup> The district court had entered judgment for the school based on (1) the affidavits and documentary evidence filed by the school and (2) the plaintiff's failure to thereafter show the existence of some proof of an essential element of his claim.

In affirming summary judgment, the Seventh Circuit relied extensively on *Celotex*, writing:

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49. 83 Bankr. 968 (N.D. Ill. 1988). Although the *Klein* case was not decided by the Seventh Circuit nor an Indiana district court, this opinion from the Northern District of Illinois is nonetheless valuable to Indiana practitioners because of its excellent interpretation of *Celotex*, coupled with the fact that the court is within the jurisdiction of the Seventh Circuit.

50. *Id.* at 970-71 (emphasis in original).

51. *Id.* at 971.

52. *Id.* (citation omitted).

53. 802 F.2d 981 (7th Cir. 1986).

54. *Id.* at 982.



In *Celotex* . . . the Supreme Court determined that Rule 56 does not require the moving party to support its . . . motion with affidavits. Instead, the moving party "bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, if any,' which it believes demonstrate the absence of a genuine issue of material fact." The moving party, however, need not support its motion with affidavits or other evidence negating the nonmoving party's claim. Once the moving party files such a properly supported motion, the non-moving party may oppose the motion with any of the evidentiary materials listed in Rule 56(c), except merely the pleadings themselves.<sup>55</sup>

"In this case," the Seventh Circuit explained, "plaintiff failed to present any affirmative evidence" of an element of his claim.<sup>56</sup> "In response to defendants' motion, plaintiff filed a brief, but did not file an affidavit or any other evidence establishing a genuine issue of fact for trial."<sup>57</sup> Thus, after the defense had properly met its initial burden under *Celotex*, the burden had shifted to the plaintiff. Because plaintiff failed to do anything more than rely on the "conclusory allegations" in his complaint, the district court had acted properly in entering summary judgment.<sup>58</sup>

Thus, *Valentine*, *Klein*, and *Nur* demonstrate that both the Seventh Circuit and the lower courts it governs have grasped the burden-shifting principles that were clarified in *Celotex*. In light of these teachings, defendants seeking summary judgment will find it easier to meet their initial burden in those cases in which it is often difficult to obtain affirmative independent evidence tending to "prove a negative." Counsel in such cases should be able to merely demonstrate to the court that the plaintiff has failed to produce even some evidence establishing an element of the *prima facie* case. Plaintiffs, on the other hand, will need to be prepared to respond to these motions by producing some evidence on each element of their case. Thus, plaintiffs will likely find it necessary to vigorously investigate their cases and conduct substantial discovery soon after filing their actions in order to fend off summary judgment motions.

Should plaintiffs need more time to investigate and respond to such a motion, they should seek relief under Rule 56(f) which allows the court

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55. *Id.* at 986 (citations omitted).

56. *Id.*

57. *Id.* at 986-87.

58. *Id.* at 987.

to refuse to rule on the motion or alternatively grant a continuance.<sup>59</sup> So long as both sides adequately apprise themselves of the importance of *Celotex*, it seems that neither the plaintiff nor defense bars will suffer any detriment in representing their clients in federal litigation.<sup>60</sup>

C. *Anderson v. Liberty Lobby, Inc.*:<sup>61</sup> *The Non-Movant's Burden—Incorporating Trial Stage Burdens of Proof Into the Summary Judgment Process*

Despite the wealth of commentary that the *Celotex* decision produced,<sup>62</sup> the specific holding did not drastically alter summary judgment practice. To be sure, the *Celotex* clarification was necessary and will continue to have an impact on federal civil procedure. However, as Judge Conover of the Indiana Court of Appeals recently noted in *Hinkle v. Niehaus Lumber Co.*,<sup>63</sup> the Indiana courts had already announced, for *Indiana* procedural purposes, the same rule which was clarified by the *Celotex* court.<sup>64</sup> Similarly, three Justices in *Celotex* declared that “the principles governing a movant’s burden of proof are straightforward and well-established, and deciding the case . . . does not require a new construction of Rule 56 at all; it simply entails applying established law to the particular facts of this case.”<sup>65</sup>

The landmark Supreme Court decision in *Anderson v. Liberty Lobby, Inc.*,<sup>66</sup> however, does *not* involve “straightforward and well-established”

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59. Rule 56(f) of the Federal Rules of Civil Procedure provides:

Should it appear from the affidavits of a party opposing the motion that the party cannot for reasons stated present by affidavit facts essential to justify the party’s opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or make such other order as is just.

For an exhaustive analysis of Rule 56(f), see WRIGHT & MILLER, *supra* note 2, at §§ 2740-41 (1983).

60. Plaintiffs can also take advantage of the *Celotex* holding by scrutinizing the defendants’ evidence supporting affirmative defenses and moving for partial summary judgment where appropriate. For an insightful discussion of plaintiff and defense tactics after the summary judgment decisions, see Kennedy, *supra* note 26, at 253-57 (1987).

61. 477 U.S. 242 (1986).

62. See, e.g., Fromme, *Celotex Lightens Movant’s Burden for Summary Judgment*, 56 J. KAN. BAR. 10 (1987); Kennedy, *supra* note 26; Note, *Celotex Corp. v. Catrett: Lessening the Moving Party’s Burden for Summary Judgment?*, 17 MEM. S.L. REV. 293 (1987); Note, *The Movant’s Burden in a Motion for Summary Judgment*, 3 UTAH L. REV. 731 (1987).

63. 510 N.E.2d 198 (Ind. Ct. App. 1987), *rev’d on other grounds*, 525 N.E.2d 1243 (Ind. 1988).

64. *Id.* at 201.

65. 477 U.S. at 335 (Brennan, J. dissenting).

66. 477 U.S. 242 (1986).



principles. To the contrary, the *Anderson* case is extraordinary, causing civil procedure scholars such as Professor Harvey to remark that the "essence of the Court's holding . . . is open to serious challenge."<sup>67</sup> Indeed, *Anderson* mandates a complete re-casting of the non-movant's burden of proof at the pre-trial summary judgment stage to take account of the higher burden of proof at trial. In order to fully grasp the potential impact of the decision, it is first necessary to examine the precise holding itself.

In *Anderson*, the plaintiffs filed a libel action alleging that certain statements and illustrations published by the defendants were defamatory. Following discovery, the defense moved for summary judgment asserting that actual malice was absent as a matter of law. In support of this contention, the publishers submitted the affidavit of the author stating that all facts in the articles were believed to be truthful and that the sources had been thoroughly researched. The affidavit included an appendix which detailed the sources for each of the statements alleged to be libelous.<sup>68</sup>

In response to the defendants' motion, plaintiffs asserted there were numerous inaccuracies in the articles and claimed that many of the author's sources were unreliable. The plaintiffs also presented evidence that prior to publication an editor of the magazine had told one of the defendants the articles were "terrible" and "ridiculous."<sup>69</sup> The plaintiffs generally charged that the petitioners had failed to adequately verify their information before publishing.

The district court entered judgment for the defendants, finding that under *New York Times*<sup>70</sup> and its progeny the plaintiffs were limited-purpose public figures and that they had to prove the presence of actual malice by clear and convincing evidence. The court reasoned that the author's thorough investigation and research, coupled with his reliance on numerous sources, precluded a finding of such malice.<sup>71</sup>

On appeal, the D.C. Circuit Court of Appeals affirmed as to twenty-one and reversed as to nine of the allegedly defamatory statements.<sup>72</sup> The crux of the district court's error, according to Judge (now Justice) Scalia, was that application of the heightened clear and convincing evidence standard was incompatible with the preliminary nature of the summary judgment inquiry. Judge Scalia reasoned that use of the clear and convincing standard at the summary judgment stage would transform

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67. 3 HARVEY, INDIANA PRACTICE § 56.4 at 167 (Supp. 1988).

68. 477 U.S. at 245.

69. 477 U.S. at 246.

70. *New York Times Co. v. Sullivan*, 376 U.S. 254 (1964).

71. *Id.*

72. *Liberty Lobby, Inc. v. Anderson*, 746 F.2d 1563 (D.C. Cir. 1984).

the motion from “a search for a minimum of facts supporting the plaintiff’s case to an evaluation of the weight of those facts.”<sup>73</sup> Moreover, Scalia feared that “paper trials” would result such that “summary judgment . . . would rarely be the relatively quick process it is supposed to be.”<sup>74</sup> The Court of Appeals then reevaluated the parties’ submissions without applying the heightened standard and determined that “a jury could reasonably conclude that the . . . allegations were defamatory, false, and made with actual malice.”<sup>75</sup> Accordingly, the Court of Appeals reversed the entry of summary judgment.

In an opinion authored by Justice White, a six-member majority of the Supreme Court vacated the decision of the Court of Appeals and remanded the case for further proceedings.<sup>76</sup> In so doing, the Court held that the heightened evidentiary standards that apply to proof of actual malice in *New York Times* cases are to be considered by the federal district courts in ruling on motions for summary judgment. Beyond this specific holding, though, the Court made it clear that, for purposes of all federal civil procedure, the “inquiry involved in a ruling on a motion for summary judgment or for a directed verdict necessarily implicates the substantive evidentiary standard of proof that would apply at the trial on the merits.”<sup>77</sup> “Thus,” Justice White wrote, “in ruling on a motion for summary judgment, the judge *must* view the evidence presented through the prism of the substantive evidentiary burden.”<sup>78</sup>

Indeed, although some state courts have erroneously interpreted *Anderson* as only applying to First Amendment cases,<sup>79</sup> a careful reading of the opinion confirms that the new directive covers *all* types of federal litigation to which Rule 56 applies. Justice Brennan confirmed this in his sharply-worded dissent, writing:

The Court’s holding today is not, of course, confined in its application to First Amendment cases. Although this case arises in the context of litigation involving libel and the press, the Court’s holding is that ‘in ruling on a motion for summary judgment, the judge must view the evidence presented through the prism of the substantive evidentiary burden.’ Accordingly, I simply do not understand why Justice Rehnquist, dissenting, feels

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73. *Id.* at 1570.

74. *Id.*

75. *Id.* at 1577.

76. 477 U.S. 242. Justice White was joined by Justices Marshall, Blackmun, Powell, Stevens, and O’Connor. Justice Brennan filed a dissenting opinion, as did Justice Rehnquist with Chief Justice Burger joining him.

77. 477 U.S. at 252.

78. *Id.* at 254 (emphasis added).

79. See *infra* notes 135-37 and accompanying text.



it appropriate . . . to remind the Court that we have consistently refused to extend special procedural protections to defendants in libel and defamation suits. The Court today does nothing of the kind. *It changes summary judgment procedure for all litigants, regardless of the substantive nature of the underlying litigation.*<sup>80</sup>

Thus, the *Anderson* holding clearly applies to all issues, "irrespective of the burden of proof required and the subject matter of the suit."<sup>81</sup> This new standard for summary judgment, the majority declared, "mirrors the standard for a directed verdict under Federal Rules of Civil Procedure 50(a), which is that the trial judge must direct a verdict if, under the governing law, there can be but one reasonable conclusion as to the verdict."<sup>82</sup>

While this new standard may appear straightforward at first glance, the majority failed to explain how the lower courts are to apply it in everyday practice. By remanding the case to the Court of Appeals to apply the new rule,<sup>83</sup> the Court side-stepped the opportunity to demonstrate its proper application. This was a common theme of the dissenters. Justice Brennan, for instance, after noting that the majority's analysis was "deeply flawed" and rested on "shaky foundations of unconnected and unsupported observations, assertions and conclusions," wrote that he was "unable to divine from the Court's opinion *how* these evidentiary standards are to be considered, or what a trial judge is actually supposed to do in ruling on a motion for summary judgment."<sup>84</sup> In Brennan's view,

[T]he Court's result is the product of an exercise akin to the child's game of "telephone," in which a message is repeated from one person to another and then another; after some time, the message bears little resemblance to what was originally spoken. In the present case, the Court purports to restate the summary judgment test, but with each repetition, the original understanding is increasingly distorted.<sup>85</sup>

Similar criticism came from Justice Rehnquist, who wrote, "Instead of . . . illustrating how the rule works, [the majority] contents itself with abstractions and paraphrases of abstractions, so that its opinion sounds

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80. 477 U.S. at 257-58 n.1 (Brennan, J., dissenting) (emphasis added).

81. *Id.*

82. *Id.* at 250 (citations omitted).

83. According to the majority, remand was necessary because the Court of Appeals "did not apply the correct standard in reviewing the District Court's grant of summary judgment . . . ." *Id.* at 257.

84. *Id.* at 257-58 (Brennan, J., dissenting) (emphasis in original).

85. *Id.* at 264-65 (Brennan, J., dissenting).

much like a treatise about cooking by someone who has never cooked before and has no intention of starting now.”<sup>86</sup> Moreover, both dissenting opinions questioned whether the new standard could really be outcome-determinative in any case.<sup>87</sup>

Notwithstanding this and other such criticisms,<sup>88</sup> *Anderson* is the law of the land for federal practice, and it must be dealt with by both federal practitioners and the courts in which they practice. Because of the nature of the majority opinion and the fact that the new rule was not applied, it is necessary to evaluate several decisions from the Seventh Circuit to guide the Indiana practitioner in this important area.

#### D. Application of *Anderson* in the Seventh Circuit

Undoubtedly, *Anderson* has had a greater impact in the Seventh Circuit to date than *Celotex*. The Seventh Circuit and the local district courts have attempted to follow the mandate of *Anderson*, and, not surprisingly, occasionally to the detriment of the plaintiff attempting to counter a defense motion for summary judgment. Three Seventh Circuit decisions and a local district court case serve as prime examples of the effect of *Anderson* on defamation suits as well as other types of civil actions.

For instance, in *Saenz v. Playboy Enterprises*,<sup>89</sup> the Seventh Circuit affirmed the entry of summary judgment against a libel plaintiff by relying heavily on the *Anderson* rule. In *Saenz*, a former government official brought an action for defamation against *Playboy* magazine alleging that one of its articles falsely accused him of complicity in the torture of political dissidents in Uruguay and Panama. One of the paragraphs of which Saenz complained read:

What no one in the Statehouse knew, or acknowledged [when they hired Saenz], was that [Saenz] had spent 17 years in the

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86. *Id.* at 269 (Rehnquist, J., dissenting).

87. That is, it may be a legitimate question to ask if there are really any cases in which summary judgment will be granted under the new standard where it would not have been under the traditional one. As Justice Rehnquist noted in his dissent:

[t]here may be more merit than the Court is willing to admit to Judge Learned Hand's observation . . . that "while at times it may be practicable" to "distinguish between the evidence which should satisfy reasonable men, and the evidence which should satisfy reasonable men beyond a reasonable doubt, . . . in the long run the line between them is too thin for day to day use."

*Id.* at 271 (Rehnquist, J., dissenting) (citation omitted). It must be noted that the D.C. Circuit Court of Appeals obviously found that the burden of proof could be outcome-determinative. *Liberty Lobby Inc. v. Anderson*, 746 F.2d 1563 (D.C. Cir. 1984).

88. See *infra* notes 146-47 and accompanying text.

89. 841 F.2d 1309 (7th Cir. 1988).



U.S. Office of Public Safety (OPS), a CIA-inspired program established in the late Fifties to advise foreign police in suppressing political dissent in Latin America and elsewhere—and then abolished by bipartisan Congressional action 20 years later amid well-documented charges of U.S. complicity in torture and political terror.<sup>90</sup>

The author then detailed some of the grotesque forms of torture that were said to have occurred, writing, “Stripped, beaten, sexually abused, tortured under water and on racks, burned with electric needles under fingernails, shocked with electrical wires on the breasts of women and testes of men, the victims described their agonies in accounts that repeatedly implicated the OPS.”<sup>91</sup> The basis of the plaintiff’s claim, then, was that “the plain and obvious import of these statements, as understood by an ordinary reader, is that Adolph Saenz personally advised foreign police in suppressing political dissent and was an accomplice to torture and political terror.”<sup>92</sup>

After discovery, *Playboy* moved for summary judgment on the grounds that the passages complained of were not published with actual malice. The district court found for the defense on this issue and entered judgment accordingly.<sup>93</sup>

In affirming the judgment of the trial court, the Seventh Circuit first noted that Saenz, as a public figure, could not succeed by merely proving that the defamatory statements were false; rather, he had to show actual malice with convincing clarity.<sup>94</sup> The court then confirmed that *Anderson v. Liberty Lobby* makes the *New York Times* burden of proving actual malice with convincing clarity applicable at the summary judgment stage.

Thus, where the factual dispute concerns actual malice, clearly a material issue in a *New York Times* case, the appropriate summary judgment question will be whether the evidence in the record could support a reasonable jury finding either that the plaintiff has shown actual malice by clear and convincing evidence or that the plaintiff has not.”<sup>95</sup>

The court then applied this standard to the parties’ submissions and found that Saenz had failed to meet the clear and convincing evidence burden. Rather, in the words of the Seventh Circuit, “the bulk of [Saenz’s]

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90. *Id.* at 1312.

91. *Id.*

92. *Id.* at 1312-13.

93. *Id.* at 1313.

94. *Id.* at 1317.

95. *Id.* (quoting *Anderson*, 477 U.S. at 255-56).

evidence merely indicates that the defendants could not reasonably have concluded that he was a torturer.”<sup>96</sup> In so ruling, the court examined several separate items of evidence that Saenz had produced in response to the motion for summary judgment.

For example, Saenz had submitted deposition testimony in which the author of the *Playboy* article admitted he had “no evidence that Mr. Saenz was involved personally in the torture in Uruguay.”<sup>97</sup> Saenz argued that “because the defendants admittedly lacked evidence of his participation in torture, ‘they *knew* their statements, either directly or in their implications and innuendo were false.’”<sup>98</sup> The Seventh Circuit, however, found this evidence insufficient under *Anderson*, writing, “At most, the plaintiff’s proof shows that the article is capable of supporting false and defamatory implications of which [the defendants], according to their uncontradicted affidavits, were unaware.”<sup>99</sup> This illustrates the power of *Anderson*, for as the court itself noted, the plaintiff had responded to the motion for summary judgment by producing “[evidence] of defamatory meaning and recklessness regarding potential falsity. . . .”<sup>100</sup> And, as the court further acknowledged, one of the allowable interpretations of the statements was that Saenz “has been accused of being a torturer.”<sup>101</sup> Despite such acknowledgement, the court nonetheless affirmed the entry of summary judgment.

After *Anderson* and *Saenz*, a plaintiff in such a case is obviously between a rock and a hard place when trying to refute the defendants’ uncontradicted affidavits that they lacked actual malice. The *Saenz* court admitted that at least *some* issue as to the defendant’s state of mind was raised by the plaintiff’s pre-trial proof, but simply refused to find the proof sufficient to meet the clear and convincing evidence burden.<sup>102</sup> The case thus illustrates that *Anderson* can make it much more difficult

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96. *Saenz*, 841 F.2d at 1318.

97. *Id.*

98. *Id.* (emphasis in original).

99. *Id.* at 1318-19.

100. *Id.* at 1318.

101. *Id.* at 1318 n.3.

102. *Id.* at 1318. Saenz also produced a letter wherein the author described Saenz as a “‘State of Seige character, with his career in Latin torture chambers . . . .’” *Id.* at 1319. The court, however, dismissed this as “indirect evidence from which no more than a mere suggestion of culpability may be drawn.” The court added, “Though relevant to the issue of malice, when considered in light of the clear and convincing evidence Saenz must ultimately produce, this one letter, standing alone, is insufficient to require a jury to resolve the plaintiff’s claimed factual dispute.” *Id.* at 1319. The court thus seems to acknowledge the probative value of this evidence, but then weighs it and, apparently because of the *Anderson* standard, finds it insufficient to carry the day. The Seventh Circuit, then, apparently believes that the *Anderson* standard *can* be outcome determinative.



to survive a properly supported motion for summary judgment when the non-movant must establish an element by clear and convincing evidence. Without the opportunity for live examination at trial, many plaintiffs may be unable to meet this new burden because of a failure of proof.

Two other cases demonstrate the Seventh Circuit's awareness that *Anderson* does not just apply to defamation cases but is instead applicable to all types of issues. For instance, in *Teamsters Local 282 Pension Trust Fund v. Angelos*,<sup>103</sup> the court applied the trial level burden of proof in disposing of a fraud action at the pre-trial stage. In *Angelos*, a pension trust fund sued a bank, its officers, and its counsel alleging the fund was fraudulently induced into making a two million dollar loan to the bank. In affirming the entry of summary judgment, the Seventh Circuit first noted that under the applicable local law the plaintiff had to show justifiable reliance by clear and convincing evidence. Then, relying on *Anderson*, the court considered "the relevant standard of proof in determining whether the nonmoving party has met its burden . . . ."<sup>104</sup> "Thus," the Seventh Circuit held, "in order to avoid summary judgment, the Fund must set forth enough facts from which a jury could find by clear and convincing evidence that it was justified in relying on the defendant's alleged misrepresentations."<sup>105</sup> Applying this standard, the court found the Fund's evidence insufficient on the issue of justifiable reliance.

Similarly, in *Scully v. United States*,<sup>106</sup> the Seventh Circuit applied *Anderson* to a federal tax case in affirming an entry of summary judgment. In *Scully*, the plaintiffs sought a refund of income taxes arguing that a bona fide loss had been sustained and should have been allowed as a deduction under the Internal Revenue Code. After noting that the plaintiffs had the burden to prove the bona fide nature of the loss, the court followed *Anderson*, writing, "To determine whether the trustees have met their burden, we must measure their evidentiary submissions against the governing legal standard."<sup>107</sup> The court then applied the trial stage burden of proof to the pre-trial Rule 56 context and affirmed the entry of summary judgment. Thus, both *Angelos* and *Scully* demonstrate the Seventh Circuit's application of *Anderson* to a wide variety of substantive issues beyond the *New York Times* defamation cases.

Finally, one of the best examples of the potential effect of *Anderson* on the Indiana federal practitioner is illustrated by a recent decision by Judge Barker of the Southern District of Indiana. In *Reed v. Ford Motor*

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103. 839 F.2d 366 (7th Cir. 1988).

104. *Id.* at 369.

105. *Id.* at 370.

106. 840 F.2d 478 (7th Cir. 1988).

107. *Id.* at 485.

Co.,<sup>108</sup> the plaintiff brought a products liability action against a truck manufacturer seeking both compensatory and punitive damages. Ford moved for partial summary judgment on the punitive damages claim, supporting its motion with the deposition testimony of the supervisor of Ford's steering column and linkage division and another Ford engineer. Both deponents testified that extensive investigative and remedial efforts had been undertaken by the manufacturer to correct the alleged design deficiencies.<sup>109</sup> In response to the motion, and perhaps as a result of an early awareness of the new burdens a non-movant faces under *Anderson*, Reed submitted "several affidavits, numerous documents, and excerpts of various depositions."<sup>110</sup>

In *denying* the defense motion for summary judgment, Judge Barker first looked to the substantive standard governing an award of punitive damages in Indiana and then incorporated this elevated trial level burden of proof at the summary judgment stage. The court wrote:

Despite the avalanche of paper filed in support of and in opposition to Ford's motion, the question for the court to resolve at the summary judgment stage remains relatively uncomplicated. The court will therefore set out the substantive standard governing punitive damage awards in Indiana, as that standard was articulated in the Indiana Supreme Court's most recent pronouncement, *Orkin Exterminating Co. v. Traina*, 486 N.E.2d 1019 (1986). The court will then apply that standard to the evidence now before the court in light of the procedural standard for summary judgment motion mandated by *Anderson v. Liberty Lobby, Inc.*

. . . .<sup>111</sup>

The court then noted the defendant's misconception of this higher burden of proof at the pre-trial stage. Ford had argued "that the plaintiff's evidence at this stage must affirmatively exclude, by clear and convincing evidence, every reasonable hypothesis that Ford's conduct was the result of 'mistake of law or fact, honest error of judgment, over-zealousness, mere negligence or other such noniniquitous human failing.'" <sup>112</sup> The proper application of *Orkin*, according to the court, articulated in the context of "*overturning a jury verdict*, could be stated as follows: Was there some evidence which a reasonable juror could have found, by a clear and convincing standard, to be inconsistent with a hypothesis that the defendant's conduct was merely the result of noniniquitous human

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108. 679 F. Supp. 873 (S.D. Ind. 1988).

109. *Id.* at 876-77.

110. *Id.* at 874.

111. *Id.* at 876 (citation omitted).

112. *Id.* at 876-77.



failing?"<sup>113</sup> To grant summary judgment on this issue, the answer would have to be "no."

"[M]indful of the impact of the United States Supreme Court's ruling in *Anderson* . . .," the court nonetheless found the plaintiff's proof sufficient to withstand the summary judgment motion.<sup>114</sup> Thus, *Reed v. Ford Motor* demonstrates that the local district courts are well aware of the mandate of *Anderson*. Also, even though summary judgment was not obtained in this instance, the case shows the potential application of *Anderson* to important issues such as punitive damages. Finally, the "avalanche of paper filed" in *Reed* illustrates the extent to which non-movants may have to go to withstand an *Anderson* motion, and may also serve as ammunition for opponents of the new standard who fear that trial by jury will be replaced with trial by affidavit.

## II. THE MORE IMPORTANT TEACHING OF *CELOTEX* AND *ANDERSON*: A NEW ATTITUDE TOWARDS SUMMARY JUDGMENT

Beyond the impact of the specific holdings, the *Celotex* and *Anderson* decisions have had an even greater effect on the federal courts' basic attitude towards summary judgment. Once treated as a narrow device to be used in limited instances, Rule 56 has suddenly become the favorite son of federal civil practice. For instance, in a two-year time frame since the Supreme Court decisions were handed down, the Seventh Circuit cited *Celotex* in twenty-two different appeals from summary judgment. Of those twenty-two cases, seventeen entries of summary judgment were affirmed while only five were reversed. Similarly, *Anderson* has been cited in thirty appeals from summary judgment, with twenty-one affirmances and nine reversals.<sup>115</sup> While such figures are admittedly of limited use,<sup>116</sup> they do help illustrate that the Seventh Circuit has followed the Supreme Court's lead into a new era for summary judgment.

The genesis for this enhancement of Rule 56 practice does not come from the *Celotex* and *Anderson* holdings alone, but rather from the extraordinary language of the summary judgment decisions. Both opinions contain a strong message, dicta though it may be, that the lower courts

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113. *Id.* at 877 (emphasis in original).

114. *Id.* at 878.

115. These figures include published opinions reported up to August, 1988.

116. It is, of course, difficult to accurately track trends in summary judgment practice. As one commentator has noted, "Empirical data as to the degree of success of summary judgment motions is deceptive, depending on the type of case, issue and moving party." See Kennedy, *supra* note 26, at 254. The Seventh Circuit percentages from this small sample, however, appear to be greater than that revealed by former studies. ("[O]ne could make a general estimate that the motion is made in 5% of cases; that over 50% are granted; and of those appealed, that over 50% are affirmed.") *Id.*

are to change their attitude towards disposing of cases at the pre-trial stage. For instance, in *Celotex* the Court declared, "One of the principal purposes of the summary judgment rule is to isolate and dispose of factually unsupported claims or defenses, and we think it should be interpreted in a way that allows it to accomplish this purpose."<sup>117</sup> Then, in closing, the Court expounded on the virtues of summary judgment, writing:

The Federal Rules of Civil Procedure have for more than 50 years authorized motions for summary judgment upon proper showings of the lack of a genuine, triable issue of material fact. Summary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed "to secure the just, speedy and inexpensive determination of every action." . . . Rule 56 must be construed with due regard not only for the rights of persons asserting claims and defenses tried to a jury, but also for the rights of persons opposing such claims and defenses to demonstrate in the manner provided by the Rule, prior to trial, that the claims and defenses have no factual basis.<sup>118</sup>

Such language is indeed a drastic shift from the "fairly harsh view" of summary judgment revealed by prior decisions of the Supreme Court.<sup>119</sup>

Similar language, of course, is found in the companion case to *Celotex*. The *Anderson* majority, for instance, analogized the summary judgment standard to that of the directed verdict, writing, "[T]his standard mirrors the standard for a directed verdict under Federal Rules of Procedure 50(a), which is that the trial judge must direct a verdict if, under the governing law, there can be but one reasonable conclusion as to the verdict."<sup>120</sup> "In essence," the Court wrote, "the inquiry under each is the same: whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is *so one-sided* that one party must prevail as a matter of law."<sup>121</sup> This is remarkable language, for it clearly implies that the lower courts are to do more than search for "genuine issues"; instead they are apparently called on to do at least some weighing of the evidence in search of "one-sidedness." Indeed, the Court goes so far as to say that "a trial judge must bear in mind the

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117. 477 U.S. 317, 323-24 (1986).

118. *Id.* at 327.

119. See Childress, *A New Era For Summary Judgments: Recent Shifts at the Supreme Court*, 116 F.R.D. 183, 183-84 (1987) (tracing some of the prior forms of discouragement).

120. 477 U.S. at 250.

121. *Id.* at 251-52 (emphasis added).



actual quantum and quality of proof" as well.<sup>122</sup> Despite the subsequent caution that the holding "does not denigrate the role of the jury,"<sup>123</sup> the other language welcoming an enhanced use of Rule 56 has not been overlooked by the Seventh Circuit.

Examples of the warm reception accorded *Celotex* and *Anderson* in the Seventh Circuit are plentiful. For instance, in *Valley Liquors, Inc. v. Renfield Importers, Ltd.*,<sup>124</sup> the Seventh Circuit cited *Anderson* writing:

A genuine issue for trial only exists when there is sufficient evidence favoring the nonmovant for a jury to return a verdict for that party. As the Supreme Court has stated, "[i]f the evidence is merely colorable, or is not significantly probative, summary judgment may be granted." We must not weigh the evidence. Instead, we must see if the nonmovant's evidence is sufficient. In determining whether evidence is sufficient, we must of necessity consider the substantive evidentiary standard of proof, for example, preponderance of the evidence, that would apply at a trial on the merits.<sup>125</sup>

Despite the disclaimer against weighing the evidence, it is apparent from such language that the trial judge is being directed to perform some "weighing," by whatever name, to determine whether the evidence is "significantly probative." This is necessary because the prescribed act, by its very nature, entails more than a superficial evaluation of the nonmovant's submissions.

Other Seventh Circuit opinions seem to go even further in their language than that used by the Supreme Court. In both *Anderson* and *Celotex*, the Court wrote that Rule 56 "mirrors" the standard for a directed verdict; the Court did not go so far as to completely equate the two. The Seventh Circuit, however, has expressly equated the standards on several occasions, writing that "the standards for granting either are the same,"<sup>126</sup> that the directed verdict is "equivalent procedurally [to] a summary judgment,"<sup>127</sup> and that summary judgment is mandated where the nonmovant "has failed to obtain enough evidence to defeat (if it were a trial) a motion for directed verdict. . . ."<sup>128</sup>

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122. *Id.* at 254.

123. *Id.*

124. 822 F.2d 656 (7th Cir. 1987), *reh'g* and *reh'g en banc denied*.

125. *Id.* at 659 (citations omitted).

126. *Hartford Accident & Indem. Co. v. Gulf Ins. Co.*, 837 F.2d 767, 774 (7th Cir. 1988).

127. *Wilson v. Chicago, Mil., St. P. & Pac. R.R.*, 841 F.2d 1347, 1353 (7th Cir. 1988).

128. *Spellman v. Commissioner*, 845 F.2d 148, 151 (7th Cir. 1988).

One of the best examples of the Seventh Circuit's reception of the summary judgment decisions is *Collins v. Associated Pathologists, Ltd.*<sup>129</sup> In affirming an entry of summary judgment in an antitrust action, the court noted that "the Supreme Court [has] made clear that, contrary to the emphasis of some prior precedent, the use of summary judgment is not only permitted but encouraged in certain circumstances, including antitrust cases."<sup>130</sup> After citing the summary judgment trilogy, the *Collins* court explained the change in attitude toward Rule 56 at length, writing:

This language [from the summary judgment cases] indicates that a summary judgment motion is like a trial motion for a directed verdict and that "genuine" allows some quantitative determination of the sufficiency of the evidence. The trial court still cannot resolve factual disputes that could go to a jury at trial, but weak factual claims can be weeded out through summary judgment motions. The existence of a triable issue is no longer sufficient to survive a motion for summary judgment. Instead, the triable issue must be evaluated in its factual context, which suggests that the test for summary judgment is whether sufficient evidence exists in the pre-trial record to allow the non-moving party to survive a motion for directed verdict.<sup>131</sup>

The *Collins* case thus clearly demonstrates the Seventh Circuit's new attitude towards this procedure.

Finally, the strongest language used by the Seventh Circuit comes from Judge Posner, who recently declared, "When it is plain that a trial could have but one outcome, summary judgment is properly granted to spare the parties and the court the time, the bother, the expense, the tedium, the pain, and the uncertainties of trial."<sup>132</sup> While such language may be unsettling to some at first glance, the important teaching is that the Supreme Court and the Seventh Circuit are walking hand-in-hand into the new era of summary judgment practice.

Although the jury is still out, so to speak, on what the ultimate effect of this shift will be, it is clear that federal summary judgment practice has changed. In this writer's opinion, the greatest effect will be seen in cases that district courts formerly thought should have been disposed of on summary judgment, but where the courts nonetheless let the matter go to trial instead because of the general hostility towards Rule 56. From this point on, that hostility will be absent, and otherwise

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129. 844 F.2d 473 (7th Cir. 1988).

130. *Id.* at 475.

131. *Id.* at 476 (citation omitted).

132. *Spellman*, 845 F.2d at 152.



factually unsupported claims will no doubt be disposed of with dispatch as the Rule contemplates.

### III. THE POTENTIAL EFFECT ON INDIANA CIVIL PROCEDURE: INDIANA COURTS SHOULD BE CAUTIOUS IN FOLLOWING THE LEADER

Whatever the outcome of the debate over the merits of the shift in federal summary judgment practice, it is clear that the change is here for the foreseeable future. Absent some model case testing the holdings on a right to jury trial basis,<sup>133</sup> summary judgment will remain more available in federal practice. Another important issue for Indiana practitioners, though, is whether the federal procedural changes will spillover to Indiana civil procedure. Although some of the federal changes may be for the better, the Indiana courts should be cautious and hesitant to adopt the *Anderson* holding and the new attitude towards summary judgment.

To date, only one reported Indiana appellate decision has cited the *Celotex* decision, and, it must be noted, without any true import. As noted previously, Judge Conover of the Indiana Court of Appeals recently declared that the burden-shifting principles clarified in *Celotex* have long been a part of Indiana summary judgment practice.<sup>134</sup> The greater potential for change comes from the *Anderson* holding and the new attitude reflected in the Supreme Court's sweeping language. No Indiana case has yet cited to *Anderson* nor taken account of the new era in federal summary judgment practice. It seems likely, though, that astute Indiana state court practitioners will soon be relying on these cases on behalf of their clients in order to dispose of claims and defenses before trial. As the Indiana courts receive the anticipated barrage, they must keep several factors in mind.

First, despite what some appellate courts from other states have said, the rule in *Anderson* was based on an interpretation of the Federal Rules of Civil Procedure, *not* on the Constitution. A careful reading of the opinion as well as a review of some of the lower federal court decisions interpreting *Anderson* confirms that this is, in fact, the case. Several state courts ruling on *New York Times* defamation cases, though, including

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133. The Seventh Amendment to the United States Constitution guarantees the right to a jury trial in federal cases, but that right is not applied to the states by the due process clause of the fourteenth amendment. See generally TRIBE, *AMERICAN CONSTITUTIONAL LAW* 568 (1978). In his *Anderson* dissent, Justice Brennan wrote, "[I]f the judge on motion for summary judgment really is to weigh the evidence, then in my view grave concerns are raised concerning the constitutional right of civil litigants to a jury trial." *Anderson*, 477 U.S. 242, 267 (1986) (Brennan, J., dissenting).

134. *Hinkle v. Niehaus Lumber Co.*, 510 N.E.2d 198, 201 (Ind. Ct. App. 1987) *rev'd on other grounds*, 525 N.E.2d 1243 (Ind. 1988).

our neighbor to the west, Illinois, summarily write things such as, "In ruling on this particular motion, we '*must* be guided by the *New York Times*' clear and convincing 'evidentiary standard . . . .'"<sup>135</sup> The West Virginia Supreme Court of Appeals recently made a similar oversight, writing:

In *Anderson v. Liberty Lobby, Inc.*, the United States Supreme Court recently addressed what standard a court *must* apply in evaluating a motion for summary judgment in a libel action filed by a public figure and concluded: "Thus, in ruling on a motion for a summary judgment, the judge must view the evidence presented through the prism of the substantive evidentiary burden . . . ."

We believe that the First Amendment to the United States Constitution and . . . the West Virginia Constitution require that trial courts apply a stricter standard in appraising defamation actions filed by public officials or public figures under a motion to dismiss . . . .<sup>136</sup>

It is clear, however, that the *Anderson* summary judgment decision did not turn on an interpretation of the First Amendment.

Other state courts have avoided this error by adopting the *Anderson* holding for all purposes of their state's Rule 56, but in doing so have displayed what could be called intellectual laziness by not carefully analyzing the arguments for and against changing their state's summary judgment practice. The Mississippi Supreme Court, for instance, recently applied *Anderson* to a fraud action without analysis, writing, "We think *Anderson* . . . is applicable to the case sub judice. . . ."<sup>137</sup> Thus, in a single stroke of the pen, the Mississippi Supreme Court radically changed Mississippi summary judgment practice, apparently without realizing (or at least disclosing to the Mississippi bar) the extent of its action. The citizens of Indiana deserve and will no doubt receive more from their state jurists.

Should an Indiana court need a role model to turn to in this instance, it need look no further than an excellent opinion handed down on the subject in 1988 by the Alaska Supreme Court. In *Moffatt v. Brown*,<sup>138</sup> the Alaska Supreme Court carefully traced the *Anderson* ruling, deter-

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135. *Davis v. Keystone Printing Serv., Inc.*, 507 N.E.2d 1358, 1367 (Ill. App. 1987) (emphasis added).

136. *Long v. Egnor*, 346 S.E.2d 778, 785-86 (W. Va. 1986) (emphasis added) (citations omitted).

137. *Haygood v. First Nat'l Bank of New Albany*, 517 So. 2d 553, 556 (Miss. 1988).

138. 751 P.2d 939 (Alaska 1988).



mined that it is a matter of federal procedural interpretation rather than First Amendment principles, and, then, after careful consideration, chose not to adopt *Anderson* as part of Alaska civil procedure. The court first explained that "in *Anderson* the Court did not set out a constitutional standard for ruling on summary judgment motions in libel cases. Instead, the Court interpreted Fed. R. Civ. P. 56 and federal summary judgment practice."<sup>139</sup> The Alaska court demonstrated this at length, writing:

The [*Anderson*] Court framed the issue . . . as a federal procedural question rather than a constitutional question . . . . The Court then analyzed federal directed verdict practice for the purpose of comparison with federal summary judgment practice. The opinion is not a detailed analysis of free speech law. Instead, it only cursorily mentions *N.Y. Times* and its progeny, and only for purposes of setting out the "clear and convincing evidence" standard applicable to actual malice issues. The Court then arrived at its general holding that "the determination of whether a given factual dispute requires submission to a jury must be guided by the substantive evidentiary standards that apply to the case." From this general holding, the Court then set down the specific rule to apply to the libel case before it . . . .<sup>140</sup>

Then, in one of the most obvious yet most important statements, the Alaska court wrote, "Since *Anderson* is a case about federal procedure, the summary judgment standard enunciated therein is *not* binding on state courts which follow their own state summary judgment procedures."<sup>141</sup> The importance of this proposition cannot be overlooked by the Indiana courts, for Alaska's Rule 56,<sup>142</sup> just like the Indiana version of Rule 56,<sup>143</sup> is almost identical to the federal counterpart from which both were derived. The language is the same; its interpretation is the key.

Despite the similarities in language, the Alaska court declined the opportunity to adopt the summary judgment standard articulated in *Anderson*, choosing instead "to continue our long-standing interpretation of our summary judgment standard as contained in [Alaska] Civil Rule 56(c)."<sup>144</sup> The court noted the reasoning of the New Jersey Supreme Court which similarly refused to apply *Anderson*, writing, "In retaining the 'genuine issue of material fact' test for summary judgment determinations,

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139. *Id.* at 942.

140. *Id.* at 943 (citation omitted).

141. *Id.* (emphasis added).

142. See ALASKA RULE CIV. P. 56.

143. See IND. RULE CIV. P. 56.

144. 751 P.2d at 943.

the New Jersey court explained 'that the clear-and-convincing test inevitably implicates a weighing of the evidence, an exercise that intrudes into the province of the jury.' We agree."<sup>145</sup> Other jurists and scholars have similarly concluded that the only possible result of adopting *Anderson* would be to force the trial judge to weigh evidence at the pre-trial stage.<sup>146</sup> As Professor Harvey noted, the "Court no longer seems concerned about 'trial by affidavit' as a substitute for trial by jury . . . ." <sup>147</sup> Before the Indiana courts consider the possibility of adopting the holding and attitude of *Anderson*, they must first determine whether there is any just cause for change, and then analyze whether the results of such a shift would be in the interests of the citizenry.

Additionally, the Indiana courts must be aware of the types of cases that such a change would impact. While *Anderson* in its fullest sense would apply to all types of issues and substantive burdens of proof, including proof by a preponderance as well as the clear and convincing standard, it is certain that the greatest effect of adopting *Anderson* would be on issues involving the latter elevated burden of proof. In Indiana, this higher evidentiary standard applies to a number of different civil issues, including awards of punitive damages,<sup>148</sup> attempts to override a patient's statutory right to refuse treatment,<sup>149</sup> efforts to impose a constructive trust,<sup>150</sup> actions seeking to terminate parental rights,<sup>151</sup> and claims by convicts alleging ineffective assistance of counsel.<sup>152</sup> If the courts choose

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145. *Id.* at 944 (citing *Dairy Stores, Inc. v. Sentinel Publishing Co.*, 104 N.J. 125, 156-57, 516 A.2d 220, 235-36 (1986)).

146. For instance, Justice Brennan's dissent explained:

I simply cannot square the direction that the judge "is not himself to weigh the evidence" with the direction that the judge also bear in mind the "quantum" of proof required and consider whether the evidence is of sufficient "caliber or quality" to meet that "quantum." I would have thought that a determination of the "caliber and quality," *i.e.*, the importance and value, of the evidence in light of the "quantum," *i.e.*, amount "required" could *only* be performed by weighing the evidence.

*Anderson*, 477 U.S. 242, 266 (1986) (Brennan, J., dissenting) (emphasis in original). As one commentator noted, "This emerging trend signals a new era for summary judgments, one in which the old presumptions are giving way to a policy of balancing and efficiency, and the mechanism is more appropriate to double as a sufficiency motion—allowing some sort of trial itself on the paper record." Childress, *supra* note 119, at 194. Such a trial on "the paper record," of course, necessarily implicates some weighing of the evidence.

147. 3 HARVEY, INDIANA PRACTICE § 56.4 at 164 (Supp. 1988).

148. See IND. CODE § 34-4-34-2 (Supp. 1988); *Orkin Exterminating Co. v. Traina*, 486 N.E.2d 1019, 1022-23 (Ind. 1986).

149. *In re Mental Commitment of M.P.*, 510 N.E.2d 645, 647 (Ind. 1986).

150. *Reiss v. Reiss*, 500 N.E.2d 1223, 1226 (Ind. Ct. App. 1986).

151. *In re Danforth*, 512 N.E.2d 228, 230 (Ind. Ct. App. 1987); see also *In re Meyer*, 471 N.E.2d 718, 720-21 (Ind. App. 1984).

152. *Robinson v. State*, 424 N.E.2d 119, 121 (Ind. 1981).



to alter the summary judgment standard, they would immediately make these types of claims more difficult.<sup>153</sup>

Finally, while the courts are admittedly not without power to so construe Rule 56 as the Supreme Court did in *Anderson*, one would hope that such a drastic change would not be undertaken without at least some type of investigation and fact-finding into the state of summary judgment practice in Indiana. Should the Indiana Supreme Court find *Anderson* appetizing, it should first seek to discover what the Indiana practitioners, trial judges, and legal scholars would put on the table. While it is conceded that some warming towards summary judgment is needed in Indiana, this author is not convinced that *Anderson* is the proper route. A decision to fully embrace *Anderson* is necessarily a partial erosion of the value of the jury trial; Indiana should proceed cautiously in such a vital area.<sup>154</sup> The courts owe it to the people to at least ensure that an informed decision is made in this regard. Should a re-writing of summary judgment be deemed best for Indiana, it should occur through the proper rule-making procedure.

#### IV. THE INTENDED AND UNINTENDED EFFECTS OF LOAN RECEIPT AGREEMENTS ON DIVERSITY JURISDICTION

A recent case decided by the United States District Court for the Southern District of Indiana raises important and novel issues about the interrelationship among loan receipt agreements, diversity jurisdiction, and forum shopping. The case of *O'Connor v. Sears, Roebuck and Co.*,<sup>155</sup> in which diversity jurisdiction was found solely because of the realignment effects of a loan receipt agreement, is important to Indiana practitioners

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153. In light of this, plaintiffs bringing such claims may want to consider the availability of forum shopping. At present, only the federal district courts in Indiana, not the state courts, will be applying *Anderson* to state law claims that involve higher burdens of proof (*i.e.*, in diversity actions or pendent claims). Thus, if a plaintiff has a choice of a state or federal forum in an action, say, involving punitive damages, the plaintiff should consider the potential effect that *Anderson* might have if the claim were brought in federal court. Assuming all other forum shopping variables were equal, a plaintiff would want to select the state forum in a punitive damages case that may be subject to summary judgment under *Anderson* for want of proof. The converse would be true for defendants who may be able to avail themselves of removal to a federal court from a state court under 28 U.S.C. § 1441.

154. Although the Seventh Amendment right to jury trial is not implicated in Indiana civil actions, the Indiana Constitution, Article I, Section 20, preserves the right of trial by jury. See generally Marsh, *Survey of Recent Constitutional Law*, 10 IND. L. REV. 124, 129 (1976); Twomley, *Right of Jury Trial Under Indiana Bill of Rights*, 20 IND. L.J. 211 (1945). Another consideration is that "trial by affidavit" precludes live examination of witnesses, one of the benchmarks of American jurisprudence.

155. No. TH 85-261-C, slip. op. (S.D. Ind. Apr. 16, 1986).

for several reasons. First, loan receipts are widely used in Indiana tort litigation and have a high propensity to enter into cases where federal diversity jurisdiction may be proper.<sup>156</sup> Second, the case is the first of its kind in that it addresses significant issues that no reported decision has covered.<sup>157</sup> Finally, the principles of *O'Connor* can be utilized by plaintiff and defendant alike in an attempt to obtain the most desirable forum, whether state or federal in the given instance.

This section of the Article will discuss *O'Connor* and its potential effect on the alignment of parties for purposes of creating or destroying diversity jurisdiction. In so doing, a brief summary of both the status of loan receipt agreements and diversity jurisdiction will be included for background purposes. And, because the *O'Connor* decision was unpublished, the full text of the eleven page opinion is reprinted at the end of this Article.<sup>158</sup>

### A. Status of Loan Receipt Agreements in Indiana

Loan receipt agreements have long been accepted and even encouraged by Indiana courts as a legitimate settlement device in actions involving multiple tortfeasors.<sup>159</sup> The Indiana Court of Appeals recently described loan receipt agreements as:

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156. A number of reported Indiana appellate decisions have dealt with loan receipt agreements. See *infra* notes 159-66 and accompanying text. Such agreements are commonly used in multiple defendant cases. Even with the advent of Indiana's Comparative Fault Act, see IND. CODE § 34-4-33-4 (1988 Supp.), "[i]t is expected that the use of loan receipt agreements will continue to flourish, although they will no longer be effective to shift liability for damages, as they were under the doctrine of joint and several liability." Eilbacher, *Comparative Fault and the Nonparty Tortfeasor*, 17 IND. L. REV. 903, 910 (1984) (assuming Comparative Fault Act abolishes doctrine of joint and several liability). Another commentator concludes that the Comparative Fault Act "eliminates the special status of loan receipt agreements by limiting the plaintiff's recovery against the nonsettling defendants to their individual percentages of fault." Smith & Wade, *Fairness: A Comparative Analysis of the Indiana and Uniform Comparative Fault Acts*, 17 IND. L. REV. 969, 984 n.90 (1984). Whatever the actual effect of the Act on the doctrine of joint and several liability (an issue that is not yet resolved by the courts nor entirely clear on its face), it nevertheless is likely that loan receipt agreements will remain commonplace in Indiana litigation practice.

157. Other reported opinions have discussed loan receipt agreements in the context of whether a party is indispensable to the action, see *Peoples Loan & Fin. Corp. v. Lawson*, 271 F.2d 529 (5th Cir. 1959), and whether a borrower is a real party in interest. See *Northern Assurance Co. v. Associated Indep. Dealers*, 313 F. Supp. 816 (D. Minn. 1970). No reported decisions have been located dealing with loan receipt agreements and realignment in diversity cases.

158. See *infra* app. pp. 139-49.

159. See, e.g., *State v. Ingram*, 427 N.E.2d 444, 446 (Ind. 1981); *American Transport Co. v. Central Indiana Ry. Co.*, 255 Ind. 319, 322-23, 264 N.E.2d 64, 66 (1970); *Ohio Valley Gas, Inc., v. Blackburn*, 445 N.E.2d 1378, 1382 (Ind. Ct. App. 1983).



devices through which a defendant who is potentially liable to a claimant advances funds in the form of a non-interest loan in return for a promise not to pursue the claim or not to enforce any judgment rendered against the lender/defendant. In exchange for limiting the liability of the agreeing defendant, the plaintiff immediately receives a guaranteed sum rather than awaiting the uncertain outcome of protracted litigation.<sup>160</sup>

Another district of the Indiana Court of Appeals has explained the policy behind these devices, writing: "We not only approve of, we encourage loan receipt agreements because 1) they provide immediate funds to those who need them, circumventing the delay inherent in a prolonged trial and appeal, and 2) they tend to settle litigation."<sup>161</sup> Unlike funds received pursuant to a covenant not to sue and/or execute, "Indiana courts have consistently held that amounts received by an injured party pursuant to a loan receipt agreement do not, *under any circumstances*, constitute partial satisfaction of any judgment which might be rendered against the remaining tortfeasors and are not to be credited against the judgment."<sup>162</sup>

This is true despite Judge Garrard's recent concurring opinion in *Sanders v. Cole Municipal Finance*,<sup>163</sup> in which he called for certain amounts paid under loan receipt agreements to be credited against the judgment secured from other co-tortfeasors. Judge Garrard explained his argument, writing:

Of course, whatever actual amounts [the plaintiffs] were obligated to repay [under the loan receipt agreement] were not and should not be treated as "satisfaction". On the other hand it seems inescapable to me that to the extent there was no obligation to repay in fact, there was a partial satisfaction and the law should recognize it.

The court in *American Transport Co.* recognized the desirability of permitting loan receipt agreements. That desirability does not appear to me to be hindered by enforcing the rule that amounts received which under the terms of the agreement need not be repaid, constitute a partial satisfaction of a plaintiff's claim.<sup>164</sup>

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160. Fullenkamp v. Newcomer, 508 N.E.2d 37, 39 (Ind. Ct. App. 1987).

161. Ohio Valley Gas, Inc., v. Blackburn, 445 N.E.2d 1378, 1382 (Ind. Ct. App. 1983).

162. Strohmeyer, *Loan Receipt Agreements Revisited: Recognizing Substance Over Form*, 21 IND. L. REV. 439, 441 (1988) (emphasis in original).

163. 489 N.E.2d 117, 124 (Ind. Ct. App. 1986).

164. *Id.* at 126 (Garrard, J., concurring).

Much the same argument was recently made by a commentator in last year's Survey issue of the *Indiana Law Review*.<sup>165</sup> However, despite these calls for modest reform of the legal effect of loan receipt agreements, it remains settled law in Indiana that such agreements do not constitute releases, and amounts received pursuant to such instruments do not constitute partial satisfaction.<sup>166</sup>

*B. Possibility of Creating Federal Diversity Jurisdiction by Way of a Loan Receipt Agreement (Whether Intentionally or Otherwise)*

In order to invoke federal diversity jurisdiction under 28 U.S.C. 1332, there must be complete diversity among the parties.<sup>167</sup> Diversity is determined as of the commencement of the plaintiff's cause of action.<sup>168</sup> "In determining whether diversity jurisdiction exists, the court is not bound by the way the plaintiff formally aligns the parties in his original pleading. It is the court's duty to 'look beyond the pleadings, and arrange the parties according to their sides in the dispute.'"<sup>169</sup> "Realignment of the parties usually will have the effect of defeating jurisdiction; the rule works both ways, however, and jurisdiction will be sustained if diversity exists when the parties are aligned properly, even though it is lacking on the face of the pleadings."<sup>170</sup>

Realignment is proper when the court finds that no actual controversy exists between parties on one side of the dispute and their formal opponents.<sup>171</sup> "In conducting its inquiry, the court may look beyond the

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165. See Strohmeyer, *supra* note 162.

166. Practitioners must use extreme care in drafting such agreements to ensure that the document cannot be construed as a release. For examples of different loan receipt agreements, see 10 *West's Forms* § 13.82- 13.84 (2d ed. 1984); *Releases Covenants, & Settlements*, § 3 (Indiana Continuing Legal Education Forum 1984); *Ohio Valley Gas, Inc. v. Blackburn*, 445 N.E.2d 1378 (Ind. Ct. App. 1983); *O'Connor v. Sears, Roebuck and Co.*, No. TH 85-261-C slip. op. (S.D. Ind. Apr. 16, 1986).

167. See *Strawbridge v. Curtiss*, 7 U.S. (3 Cranch) 267 (1806); *Owen Equipment & Erection Co. v. Kroger*, 437 U.S. 365 (1978); 13B C. WRIGHT, A. MILLER & E. COOPER, *FEDERAL PRACTICE AND PROCEDURE* § 3605 (2d ed. 1987) [hereinafter WRIGHT, MILLER & COOPER].

168. See, e.g., *Hoefflerle Truck Sales, Inc. v. Divco-Wayne Corp.*, 523 F.2d 543 (7th Cir. 1975). Thus, changes immediately prior or subsequent to the date of filing the action have no effect on diversity jurisdiction. This rule is not attributable to any specific statutory language, but is rather a policy decision intended to provide stability and certainty in resolving issues of subject matter jurisdiction. See generally 13B WRIGHT, MILLER & COOPER, *supra* note 167, at § 3608.

169. 13B WRIGHT, MILLER & COOPER, *supra* note 167, § 3607, at 430 (quoting *City of Dawson v. Columbia Avenue Savings Fund*, 197 U.S. 178, 180 (1905)).

170. 13B WRIGHT, MILLER & COOPER, *supra* note 167, § 3607, at 430.

171. *Indianapolis v. Chase Nat'l Bank*, 314 U.S. 63 (1941). See generally 13B WRIGHT, MILLER & COOPER, *supra* note 167, at § 3607.



pleadings and consider the nature of the dispute in order to assess the parties' real interests."<sup>172</sup> "The propriety of alignment is a matter not determined by mechanical rules, but rather by pragmatic review of the principal purpose of the action and the controlling matter in dispute."<sup>173</sup> Moreover, "it is the points of substantial antagonism, not agreement, on which the realignment must turn."<sup>174</sup> Accordingly, "a mere mutuality of interest . . . is not of itself sufficient to justify realignment. Realignment is proper where there is no actual, substantial conflict between the parties that would justify placing them on opposite sides of the lawsuit."<sup>175</sup>

Given the flexible nature of these principles, each case presented to the federal courts turns on its own facts and the "principal purpose" of the plaintiff's action. Although the great majority of realignment cases stem from removal actions (where the action, originally brought in state court, appears non-diverse on its face), there is nothing to prevent a plaintiff from originally filing the facially non-diverse action in federal court and then seeking realignment. Nor is it improper to fashion the action in such a way that realignment is warranted, for 28 U.S.C. 1359 only forbids jurisdiction over actions "in which any party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court." This provision has been narrowly construed and generally applies to instances in which residents of other states are somehow improperly joined to manufacture diversity.<sup>176</sup>

It is, then, theoretically possible to enter into a loan receipt agreement with a non-diverse defendant that removes all "actual, substantial conflict" between the non-diverse parties (with or without the intention to have this effect on diversity). This is so because loan receipt agreements can be fashioned (and usually are so fashioned) in such a way that the non-diverse defendant actually favors a progressively larger recovery from the other co-tortfeasors. For instance, in the simplest agreement the recipient of the non-interest loan agrees to repay the funds

solely from and out of any judgment I obtain against defendant which exceeds \_\_\_\_ dollars. I further agree that I will use and pursue any reasonable and legal means which are available to me to collect any judgment I obtain against defendant.<sup>177</sup>

Thus, the defendant who enters into this agreement will benefit only if recovery is obtained from the other tortfeasor.

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172. *American Motorists Ins. v. Trane Co.*, 657 F.2d 146, 149 (7th Cir. 1981).

173. *Id.* at 151.

174. *Id.*

175. *Id.*

176. *See generally* 14 WRIGHT, MILLER & COOPER, *supra* note 167, at § 3637.

177. 10 WEST'S FORMS § 13.84 (1987).

Interestingly enough, one commentator discussing loan receipt agreements, though not their effects on realignment, seemed to anticipate the potential realignment effects of loan receipts:

Once the loaning defendant has advanced funds to the plaintiff, the defendant's interest in the trial has shifted because now the defendant has become *aligned with the plaintiff* in that the defendant would benefit through repayment of the loan should the plaintiff recover from the nonsettling defendant. Since no litigable issue remains between the plaintiff and the loaning defendant, the loaning defendant's only purpose for continuing to participate in the trial is to assist the plaintiff in recovering from the nonsettling defendant. For this reason, [Indiana] courts have held that if the loaning defendant is not dismissed from the lawsuit, once the loan receipt agreement is made known, the nonsettling defendant may move for a separate trial and/or introduce the loan receipt agreement into evidence [for impeachment purposes].<sup>178</sup>

Surprisingly, no reported decisions have been found dealing with the effects of loan receipts on diversity jurisdiction. However, an unpublished 1986 order from Judge Brooks of the Southern District of Indiana would serve as substantial precedent in this area. In *O'Connor v. Sears, Roebuck and Co.*,<sup>179</sup> an Indiana youth was seriously injured while operating a Sears log splitter. O'Connor brought a products liability action against the manufacturers, as well as a negligence action against the owner of the machine, Ralph Key, an Indiana domiciliary. Prior to initiating his lawsuit, O'Connor entered into a loan receipt with Key providing the plaintiff with \$25,000 of immediate funds.<sup>180</sup> This agreement also provided that \$10,000 more would be paid by Key if O'Connor did not recover anything from Sears. However, progressively larger amounts would be repaid to Key (up to the full \$25,000) as the recovery from Sears increased. After entering this agreement, the plaintiff then filed his action in state court, naming Sears and Key as defendants.<sup>181</sup>

Sears, an Illinois and New York resident for diversity purposes,<sup>182</sup> removed the action to federal court on the grounds that complete diversity

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178. Strohmeyer, *supra* note 162, at 441 n.11 (emphasis added).

179. No. TH 85-261-C slip. op. (S.D. Ind. Apr. 16, 1986).

180. A loan receipt agreement was also entered into with defendant Howard, an Indiana domiciliary upon whose land the injury occurred. For simplicity sake this Article will only discuss defendant Key.

181. *O'Connor v. Sears, Roebuck and Co.*, No. TH 85-261-C slip. op. at 1-3.

182. For purposes of determining diversity, corporations are treated as citizens of their place of incorporation and their principal place of business. 28 U.S.C. § 1332(c).



existed because of the loan receipt agreement. That is, Sears argued that Key (who, as an Indiana resident, was formerly non-diverse to the Indiana plaintiff, thereby precluding diversity) should be realigned as a plaintiff because his ultimate interests were with the plaintiff due to the loan receipt.

In an eleven page unpublished opinion, Judge Brooks agreed with Sears, holding realignment proper because no collision of interests existed between the plaintiff and the non-diverse defendants. The court wrote:

The only conceivable scenario for Key and Howard to incur a further loss is if judgment is entered against them in their individual capacities with all remaining co-defendants found not liable. This contingency, as evidenced by the loan receipt agreement, is remote at best because the plaintiffs are looking to secure judgment against Sears and Didier only. Finally, although Key and Howard may have to tender additional monies, such position does not merit a collision of interest, for throughout litigation of this cause Key and Howard will continually hope for judgment against Sears and Didier. The bigger the judgment against Sears and Didier, the more delighted Key and Howard.<sup>183</sup>

The *O'Connor* court simply found that under the terms of the loan receipt, the Indiana defendants' interests "lie with the plaintiffs, for it is in [the Indiana defendants'] best interest for the plaintiffs to secure a judgment against Sears and Didier."<sup>184</sup> Accordingly, it was difficult for the court "to contemplate a collision of interests" sufficient to preclude realignment of the Indiana defendants as plaintiffs for diversity purposes.<sup>185</sup>

Thus, *O'Connor* initially illustrates that plaintiffs must be extremely cautious in entering loan receipt agreements, for if a state court forum is desired, counsel should ensure that such an agreement will not unintentionally create diversity. Defendants seeking a federal forum, on the other hand, may be able to use *O'Connor* to their advantage by removing the state action to federal court under 28 U.S.C. 1441.

The tables can apparently also be turned even further. Although the *O'Connor* case found its way to federal court by way of removal, the diversity principles for original and removal actions are identical.<sup>186</sup> Although a court may be more reluctant to find diversity jurisdiction where

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183. *O'Connor v. Sears, Roebuck and Co.*, No. TH 85-261-C slip. op. at 10.

184. *Id.* at 11.

185. *Id.*

186. See *supra* note 170 and accompanying text.

the plaintiffs have sought to create it themselves,<sup>187</sup> a federal court would be hard pressed to distinguish away the general principles announced by the Supreme Court and the Seventh Circuit, and the specific application of these maxims by the *O'Connor* court in the loan receipt context.

The fact that the *O'Connor* decision was unpublished does not mean it is without precedential value. Unlike the rules governing Indiana state court practice,<sup>188</sup> there is no federal rule prohibiting counsel from citing to unpublished opinions. To the contrary, the federal courts often find precedential value in unpublished opinions, recognizing that the district court judges in particular seldom publish their decisions. Indeed Rule 12 of the Local Rules for the Southern District of Indiana was recently amended to provide that parties relying on unpublished authority must furnish the court with a copy of such authority.<sup>189</sup> And, the Local Rules for the Seventh Circuit similarly allow unpublished opinions to be cited so long as a copy of the opinion is served on the court and the parties.<sup>190</sup> Although the Local Rules for the Northern District of Indiana do not speak to this matter, there is nothing prohibiting counsel from following the suggestion of the Southern District rule.<sup>191</sup>

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187. The burden to establish subject matter jurisdiction is always on the party asserting it. *See generally* 13B WRIGHT, MILLER, & COOPER, *supra* note 168, § 3602, at 375. Whether logical or not, courts are naturally more skeptical about the existence of diversity when the party attempting to manufacture diversity has the burden of proof. A more appealing case is presented where the party seeking diversity jurisdiction (*i.e.*, the removing party) does so as a result of the opponent's activities.

188. Rule 15(A)(3) of the Indiana Rules of Appellate Procedure provides that "memorandum decisions shall not be published nor shall they be regarded as precedent nor cited before any court except for the purpose of establishing the defense of res judicata, collateral estoppel or the law of the case." No such rule governs federal practice.

189. An addition made to Local Rule 12 effective April 22, 1988, provides:

If a party relies upon a legal decision not published in the Federal Supplement, Federal Rules decisions, Federal Reporter, Federal Reporter 2d, The United States Reports, Bankruptcy Reporter, North Eastern Reporter, North Eastern Reporter 2d, or on a statute or regulation not found in the current publication of the United States Code, the United States Patent Quarterly, the Code of Federal Regulations, the Indiana Code, or the Indiana Administrative Code, then the party shall furnish the Court with a copy of the relied-upon decision, statute or regulation. With respect to decisions of the Supreme Court of the United States not yet available in United States Reports, citation should be made both to the Supreme Court Reporter and to Lawyers Edition Second.

General Rule 12 of the Rules of the United States District Court for the Southern District of Indiana, *reprinted in* 31 RES GESTAE 575 (June 1988). Although the primary aim of this rule appears to be reported decisions from regional reporters other than the *Northeastern Reporter*, the Rule certainly is applicable to unpublished decisions in general.

190. *See* Seventh Circuit Rule 28(d).

191. There is no magical reason why a published opinion should be of any greater precedential value than an unpublished opinion that is brought to the attention of the court and the parties.



Thus, practitioners in multiple party litigation considering loan receipt agreements must determine whether the agreement will create or destroy the possibility of diversity jurisdiction. If a party has a particular desire to be heard in either a state or federal forum, the use of a loan receipt agreement may help or impede that cause in certain situations.<sup>192</sup> The *O'Connor* decision demonstrates that both plaintiffs and defendants may gain some flexibility in selecting their desired forum through loan receipt agreements.<sup>193</sup>

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192. Ultimately, the decision whether to proceed in state or federal court must be determined under the particular circumstances of each individual client and case. Some writers contend that there is no longer much reason to have any great preference for one forum over the other. *See, e.g.*, 14 WRIGHT, MILLER & COOPER, *supra* note 167, § 3637, at 90-91 (outlining the arguments for and against forum shopping). Some practitioners may simply desire the less formal environment of most state courts, while others may seek the resources of the federal forum. Some more substantive reasons may remain, however, for as discussed in the first section of this Article, an Indiana practitioner will encounter different standards for summary judgments in federal court than in the Indiana state courts. For an excellent discussion of the hows and whys of forum shopping among state and federal courts, see RAEDER, *FEDERAL PRETRIAL PRACTICE*, ch. 1 (1988).

193. It should be noted that a savings clause in Indiana's statute of limitations has been interpreted to allow plaintiffs whose claims are dismissed from federal court to renew their claims in state court at any time within five years of the dismissal. *See* IND. CODE 34-1-2-8 (1982); *Torres v. Parkview Foods*, 468 N.E.2d 580, 582-83 (Ind. Ct. App. 1984); *Huffman v. Anderson*, 118 F.R.D. 97, 100 (N.D. Ind. 1987). Thus, if the above strategy is unsuccessful, the dismissed action could be re-filed in state court.

APPENDIX

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF INDIANA  
TERRE HAUTE DIVISION

JAMES D. O'CONNOR and	)	
DAVIN C. O'CONNOR	)	
Plaintiffs	)	
	)	
vs.	)	CAUSE NO. TH 85-261-C
	)	
SEARS, ROEBUCK AND CO.,	)	
DIDIER MANUFACTURING COMPANY,	)	
PAUL E. HOWARD and RALPH KEY,	)	
Jointly and Severally	)	
Defendants	)	

ORDER

This matter is before the Court upon the motion of the plaintiffs, James D. O'Connor and Davin C. O'Connor, and the defendants, Paul E. Howard and Ralph Key, to remand this cause to state court. Defendants Sears, Roebuck and Co. ("Sears") and Didier Manufacturing Company ("Didier") having heretofore filed a verified petition for removal, the Court finds the matter ripe for decisions.

This cause was originally filed in the Owen County Circuit Court, State of Indiana, on August 12, 1985, and subsequently removed to this Court on September 12, 1985. The verified petition for removal shows that plaintiffs and defendants, Howard and Key, are residents of Indiana. Sears is a corporation formed under the laws of the State of New



York, with its principal-place of business at Chicago, Illinois; Didier is a corporation formed under the laws of the State of Wisconsin, with its principal place of business at Milwaukee, Wisconsin.

#### FACTUAL SUMMARY

Ralph Key purchased a log splitter from Sears that was manufactured by Didier. The log splitter was in the custody of Paul E. Howard when the accident occurred. Plaintiff, Davin O'Connor, a minor, was operating the log splitter when the accident occurred. The minor and his parents bring this products liability and strict liability tort case against the defendants.

On February 8, 1985, Howard and his insured entered into a loan receipt agreement with the plaintiffs whereby Howard and his insured would contribute \$50,000.00 to the plaintiffs. The loan agreement provides that if the settlement or verdict is less than \$50,000.00, the plaintiffs have no obligation to repay the loan. The agreement provides for other contingencies as well, but the pertinent part here is that in the event plaintiffs are unable to recover against the other defendants, then Howard may be liable for an additional \$20,000.00 depending on the relevant contingency. Defendant Key also entered into a loan receipt agreement

with similar contingencies with the only difference being that Key and his insured contributed \$25,000.00, and any additional liability is limited to \$10,000.00.

#### ISSUE

Where two nondiverse defendants and their insureds have entered into loan receipt agreements with the plaintiffs, may diversity jurisdiction exist where there is no longer a collision of interests between the plaintiffs and the two nondiverse defendants.

#### MEMORANDUM

Title 28 U.S.C. § 1441(a) reads as follows:

§ 1441. Actions removable generally

"(a) Except as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant or the defendants, to the district court of the United States for the district and division embracing the place where such action is pending."

In the instant case, Didier and Sears seek removal based on diversity of citizenship, pursuant to 28 U.S.C. 1332 with the amount in controversy exceeding \$10,000.00, exclusive of interest and cost.



Since lack of jurisdiction would make any decree void, the removal statute should be strictly construed and all doubts should be resolved in favor of remand. 14 C. Wright, A. Miller & E. Cooper, Federal Practice and Procedure, § 3642 at 149 (2d ed. 1985). The defendant's right to removal is determined at the time the removal petition is filed by looking at plaintiffs' pleading, and it is the defendant's burden to show the existence of federal jurisdiction. Pullman Company v. Jenkins, 305 U.S. 534, 537, 540, 59 S.Ct. 347, 348, 350, 83 L.Ed. 334 (1939).

It has long been held that diversity of citizenship between plaintiffs and defendants must be complete. Strawbridge v. Curtiss, 7 U.S. (3 Cranch) 267, 2 L.Ed. 435 (1806); Owen Equipment & Erection Co. v. Kroger, 437 U.S. 365, 98 S.Ct. 2396, 57 L.Ed. 2d 274 (1978). Moreover, when determining whether complete diversity exists, the federal courts are "to disregard nominal or formal parties and rest jurisdiction only upon the citizenship of real parties to the controversy." Navarro Savings Ass'n v. Lee, 446 U.S. 458, 461, 100 S.Ct. 1779, 1782, 64 L.Ed. 2d 425 (1980).

In determining whether diversity jurisdiction exists, the alignment of the parties as plaintiffs and defendants in the pleadings is not conclusive. The Court must "look beyond the pleadings and arrange the parties according to their sides

in the dispute." City of Dawson v. Columbia Ave. Sav. Fund Safe Deposit, Title & Trust Co., 197 U.S. 178, 180, 25 S.Ct. 420, 421, 49 L.Ed. 713 (1905). Realignment is proper when the Court finds that no actual substantial controversy exists between parties on one side of the dispute and their opponents. Indianapolis v. Chase National Bank, 314 U.S. 63, 62 S.Ct. 15, 86 L.Ed. 47 (1941). Hence, in alignment cases, the proper focus by the Court is on the collision of interests among the nondivergent parties. American Mutual Liability Insurance Co. v. Flintkote Co., 565 F.Supp. 843 (S.D.N.Y. 1983). Finally the ultimate decision of whether to realign the parties is left to a pragmatic review of the principal purpose of the action and the controlling matter in dispute. American Motorists Ins. Co. v. Trane Co., 657 F.2d 146, 151 (7th Cir. 1981).

The record before the Court reveals that defendants, Key and Howard, have both entered into loan receipt agreements. Although this Court has given such agreements considerable cerebation, Indiana courts have continually upheld loan receipt agreements. Klukas v. Yount, 121 Ind. App. 160, 98 N.E.2d 227 (1951); State v. Thompson, 385 N.E.2d 198 (Ind. App. 1st Dist. 1979). Each loan receipt agreement provides that Key and Howard, along with their respective insureds, have tendered a sum of \$75,000.00 to the plaintiffs.



(Although Howard's loan agreement is the only one on file, there is an uncontroverted affidavit that Key has entered into a loan receipt agreement as well.) The loan is controlled by the loan receipt agreement, and the agreement provides for several contingencies. The agreements place a cap on the recovery that the plaintiffs may recover against Key and Howard.

For Howard there are basically four contingencies in the loan receipt agreement which, in pertinent part, read as follows:

"2. In the event the total amount received by the O'Connors by way of judgment, settlement, or otherwise from Sears, Didier, and Keys (sic), or any one or more of them, is less than Two Hundred Thousand Dollars (\$200,000.00) or its equivalent in annuities, contracts, or other structured settlements, then the entire Fifty Thousand Dollars (\$50,000.00) debt shall be forgiven and the O'Connors shall be entitled to retain forever the amounts lent to them under paragraph 1 above, and O'Connors promise and covenant never to execute or attempt to collect any further sums from Paul E. Howard or his insurers, regardless of the size of any judgment or judgments that may hereafter be rendered against Paul E. Howard."

"3. In the event the total amount received by the O'Connors by way of judgment, settlement, or otherwise from Sears, Didier, and Keys (sic), or any one or more of them, is equal to or greater than Two Hundred Thousand Dollars (\$200,000.00) or its equivalent in annuities, contracts, or other structured settlements, but less than Five Hundred Thousand Dollars (\$500,000.00) or its equivalent in annuities, contracts, or other structured settlements,

then the O'Connors shall be jointly and severally liable to repay to Indiana Farmers Group the sum of Twenty Thousand Dollars (\$20,000.00), and the remaining Thirty Thousand (\$30,000.00) of the debt shall be forgiven and the O'Connors shall be entitled to retain forever the remaining Thirty Thousand Dollars (\$30,000.00) lent to them under paragraph 1 above, and O'Connors promise and covenant never to execute or attempt to collect any further sums from Paul E. Howard or his insurers, regardless of the size of any judgment or judgments that may hereafter be rendered against Paul E. Howard."

"4. In the event the total amount received by the O'Connors by way of judgment, settlement, or otherwise from Sears, Didier, and Keys (sic), or any one or more of them, is equal to or greater than Five Hundred Thousand Dollars (\$500,000.00) or its equivalent in annuities, contracts, or other structured settlements, then the O'Connors shall be jointly and severally liable to repay to Indiana Farmers Group the entire sum of Fifty Thousand Dollars (\$50,000.00) lent to them under paragraph 1 above, and O'Connors promise and covenant never to execute or attempt to collect any sums from Paul E. Howard or his insurers, regardless of the size of any judgment or judgments that may hereafter be rendered against Paul E. Howard."

"5. In the event that after all legal remedies have been exhausted, the O'Connors can recover nothing by way of judgment, settlement, or otherwise from Sears, Didier, Keys (sic), or their insurers, and one or more enforceable judgments are rendered against Paul E. Howard only, and in favor of one or more of the O'Connors, then

(a) in the event the total of said judgment or judgments is for an amount less than or equal to Fifty Thousand Dollars (\$50,000.00), the entire Fifty



Thousand Dollars (\$50,000.00) debt shall be forgiven as full payment of said judgment, and O'Connors promise and covenant never to execute on or attempt to enforce or collect said judgment or judgments against Paul E. Howard or his heirs, successors, or insurers; or,

(b) in the event the total of said judgment or judgments is for an amount greater than Fifty Thousand Dollars (\$50,000.00), but less than or equal to Seventy Thousand Dollars (\$70,000.00), the entire Fifty Thousand Dollars (\$50,000.00) debt shall be forgiven as payment of Fifty Thousand Dollars (\$50,000.00) toward said judgment or judgments, and the O'Connors shall be entitled to collect the remaining unpaid total amount of said judgment or judgments, but no more; or,

(c) in the event the total of said judgment or judgments is for an amount greater than Seventy Thousand Dollars (\$70,000.00), the entire Fifty Thousand Dollars (\$50,000.00) debt shall be forgiven as payment of Fifty Thousand Dollars (\$50,000.00) toward said judgment or judgments, and the O'Connors shall be entitled to collect only an additional Twenty Thousand Dollars (\$20,000.00) on said judgment or judgments in the aggregate and O'Connors promise and covenant never to execute on or attempt to enforce or collect, except to the extent of said Twenty Thousand Dollars (\$20,000.00), said judgment or judgments against Paul E. Howard or his heirs, successors, or insurers."

Key's loan receipt agreement is substantially the same, but with the dollar amount not being as large.

Sears and Didier, in their brief in support of removal, contend that Key and Howard are no longer real parties in interest, for they no longer have a stake in the outcome of this cause by virtue of their signing the loan agreements. In furtherance of this position, Sears and Didier point to the loan agreement and the language therein. For example, the loan receipt agreements characterize the present cause as a complaint for products liability and strict liability against Sears and Didier. The agreement also states that chances of recovery against Key and Howard are "remote, because the real and primary parties at fault and liable for the O'Connors' injuries and damages are Didier and/or Sears." Moreover, as noted in the agreement, the only prospect of additional liability of Key and Howard to the plaintiffs would occur only if judgment is secured against them individually. Even if this contingency occurs, the liability is limited to a sum certain as found in the loan receipt agreement. Hence, Sears and Didier are contending that no collision of interests exists between Key and Howard with Sears and Didier

The plaintiffs, along with Key and Howard, maintain that Key and Howard do have a stake in the outcome of this cause by the contingency of additional liability in the event plaintiffs do not recover against the co-defendants. Thus, their argument is that a collision of interests does exist,



and, therefore, diversity jurisdiction is destroyed by having citizens of the same state on opposite sides.

After careful review of the loan receipt agreement and the relevant case law, the Court finds that Key and Howard do not have a collision of interests with the plaintiffs for the reasons stated above and hereinbelow.

Pursuant to the loan receipt agreements, Key's and Howard's interest lie with the plaintiffs, for it is in Key's and Howard's best interest for the plaintiffs to secure a judgment against Sears and Didier. There exist contingencies for plaintiffs to repay all or a portion of the loan to Key and Howard depending who is adjudged liable and the size of the damage award. The only conceivable scenario for Key and Howard to incur a further loss is if judgment is entered against them in their individual capacities with all remaining co-defendants found not liable. This contingency, as evidenced by the loan receipt agreement, is remote at best because the plaintiffs are looking to secure judgment against Sears and Didier only. Finally, although Key and Howard may have to tender additional monies, such position does not merit a collision of interest, for throughout litigation of this cause Key and Howard will continually hope for judgment against Sears and Didier. The bigger the judgment against

Sears and Didier, the more delighted Key and Howard. Consequently, it is difficult to contemplate a collision of interests. With proper alignment of parties, diversity jurisdiction is found to exist.

Accordingly, the motion to remand filed by the plaintiffs, Key and Howard, is hereby ORDERED DENIED.

IT IS SO ORDERED this [10th] day of April, 1986.

[signature on original]<sup>194</sup>  
Gene E. Brooks, Judge  
United States District Court

cc: Distribution to all counsel of record

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<sup>194</sup>A copy of the original, signed opinion is available from the Clerk, United States District Court, Southern District of Indiana, Terre Haute Division, Terre Haute, Indiana.





# Discoverability of Privileged Physician-Patient and Peer Review Communications: Not What the Doctor Ordered

PETER M. RACHER\*

The most fundamental goal of the trial process is the discovery of truth. Yet the truth-seeking function is subverted by the rules of privilege, which have as their objective the suppression of credible and often critical information in the furtherance of some extrinsic social policy. Privileges are justified only by their "protection of interests and relationships which, rightly or wrongly, are regarded as of sufficient social importance to justify some incidental sacrifice of sources of facts needed in the administration of justice."<sup>1</sup> That is why privileges are generally looked upon with disfavor and are strictly construed to limit their application.

During the survey period, Indiana courts have announced several new rules with regard to the discovery of privileged communications, particularly as concerns the medical community. Doctors and patients will be surprised to learn that privileged physician-patient communications now are discoverable, although not necessarily admissible. Meanwhile, communications of medical "peer review" committees have been held to be virtually absolutely insulated from discovery, which means doctors and other health-care providers will find it more difficult to defend against challenges to their professional qualifications.

Indiana courts also have announced decisions construing the privileges attaching to confidential spousal and attorney-client communications, and have emphatically rejected the once-touted "self-analysis" privilege notwithstanding its embrace by some federal courts.

## I. PHYSICIAN-PATIENT COMMUNICATIONS: *Canfield v. Sandock*<sup>2</sup>

The Indiana Civil Code of 1881 provides in pertinent part:

The following persons shall not be competent witnesses:

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Fourth. Physicians, as to matter communicated to them, as such, by patients, in the course of their professional business, or advice given in such cases . . . .<sup>3</sup>

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\* Associate, Pendygraft & Plews, Indianapolis. B.A., Oberlin College, 1978; J.D. (*magna cum laude*), Indiana University School of Law-Bloomington, 1986.

1. Ernst & Ernst v. Underwriters Nat'l Assur. Co., 381 N.E.2d 897, 901 (Ind. Ct. App. 1978) (quoting McCORMICK, EVIDENCE § 74, at 152 (2d ed. 1972)).

2. 521 N.E.2d 704 (Ind. Ct. App. 1988).

3. IND. CODE § 34-1-14-5 (1988).



The statute appears to absolutely prohibit testimony by physicians as to applicable physician-patient communications but it long has been construed as a privilege which the patient may claim or waive.<sup>4</sup> The purpose of the privilege is to foster the patient's unqualified confidence in his physician and to give the patient the assurance that communications with the physician will be treated as confidential.<sup>5</sup> The privilege is not absolute. It applies only to those communications necessary to treatment or diagnoses;<sup>6</sup> the privilege may be invoked only on the patient's behalf<sup>7</sup> by the patient himself and not by the patient's parent;<sup>8</sup> and the privilege protects only communications to physicians as opposed to other health-care providers<sup>9</sup> (although communications to chiropractors fall within the privilege).<sup>10</sup> When a patient puts in issue his medical or mental condition, the privilege is waived as to all matters either historically or causally connected to the matters put in issue.<sup>11</sup>

In *Canfield v. Sandock*,<sup>12</sup> the court of appeals held that a litigant may discover arguably privileged physician-patient communications by way of a request for production served directly upon a non-party physician pursuant to Trial Rule 34(C).<sup>13</sup> The case, a negligence action arising from an automobile-pedestrian accident, illustrates the tension in personal injury actions between the need for confidentiality of physician-patient communications and the need for some workable means of identifying which medical information is non-privileged by virtue of its relevance to the matters at issue.

In *Canfield*, the injured pedestrian and his wife sued for damages arising from the husband's physical injury, pain and mental suffering. The plaintiffs also sought recovery for the wife's loss of consortium. The defendant sought from the plaintiff's physician, pursuant to Trial Rule 34(C):<sup>14</sup>

a copy of each and every document contained within your file pertaining to plaintiff . . . . This request includes, but is not

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4. Penn Mut. Life Ins. Co. v. Wiler, 100 Ind. 92 (1885).

5. Pennsylvania Co. v. Marion, 123 Ind. 415, 421, 23 N.E. 973, 975 (1890).

6. Collins v. Bair, 256 Ind. 230, 268 N.E.2d 95 (1971); Myers v. State, 192 Ind. 592, 599, 137 N.E. 547, 550 (1922); State v. Jagers, 506 N.E.2d 832, 833 (Ind. Ct. App. 1987).

7. Hauk v. State, 148 Ind. 238, 46 N.E. 127 (1897); Jagers, 506 N.E.2d at 834.

8. Lomax v. State, 510 N.E.2d 215, 219 (Ind. Ct. App. 1987).

9. Whitehead v. State, 511 N.E.2d 284, 294 (Ind. 1987).

10. Jagers, 506 N.E.2d at 833.

11. Collins, 256 Ind. at 241, 268 N.E.2d at 100-01.

12. 521 N.E.2d 704 (Ind. Ct. App. 1988).

13. IND. R. TR. P. 34(C).

14. *Id.*

limited to, copies of any and all physician's notes, nurse's notes, clinical reports, hospital reports, laboratory reports, questionnaires completed by the patient, and any other document contained within your file.<sup>15</sup>

The trial court granted a protective order barring discovery of the requested documents and granted attorney's fees to plaintiffs' counsel pursuant to Trial Rules 26(C) and 37(A)(4).<sup>16</sup> The defendant filed an interlocutory appeal challenging the protective order and fee award.

Preliminarily, the court of appeals determined that a Rule 34(C) request for production of documents upon a non-party is an appropriate vehicle for discovering medical records, notwithstanding the theoretical risk that a physician may respond to such a request before the patient has an opportunity to invoke the privilege.<sup>17</sup> The court also noted that a party-patient who injects his medical condition into the litigation necessarily waives his privilege as to the medical matters put in issue.<sup>18</sup> The difficulty arises when some of a party-patient's medical information is relevant and therefore non-privileged and discoverable, but some is irrelevant and therefore still privileged. How is the court to determine which medical information may be discovered?

The usual answer is to conduct an *in camera* inspection of the disputed materials so that the court may determine which items are relevant and discoverable and which are not. The court of appeals, however, concluded that in the case of medical records an *in camera* inspection is unworkable due to the "unique technical nature of medical information."<sup>19</sup> Medical information is so complex that the trial court must have expert guidance in determining which information is causally or historically connected to the medical condition in issue, especially where the plaintiff describes his damages with such unspecific terms as "physical injury" and "mental suffering." The only workable procedure

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15. 521 N.E.2d at 706.

16. IND. R. TR. P. 26(C), 37(A)(4).

17. The possibility that attorneys might take advantage of Rule 34(C) to obtain privileged materials was deemed too speculative to warrant limiting the use of Rule 34(C) in the pursuit of medical records. *Canfield*, 521 N.E.2d at 706.

18. *Id.*

19. The court stated:

It is not practical to assume a trial judge has such a high degree of medical knowledge to know what portions of a medical history might bear on the condition at issue without the benefit of expert opinion. This is especially true where, as here, the pleadings refer to the condition in such general terms as "physical injury" and "mental suffering."

521 N.E.2d at 707. It is not apparent why trial courts are less well-equipped to decipher technical medical information than they are as to technical business or scientific information, matters which are grist for the courts.



is to (1) let the discovering party have access to the disputed materials and (2) convene a hearing where the court can hear argument and expert opinion from both parties as to whether the material bears a relation to the medical condition in issue. In other words, the only way to determine whether medical material is privileged is to breach the privilege, giving the discovering party what it seeks so that the party may then argue in favor of discovery.

The court was sensitive to the fact that its approach entailed an obvious degree of circularity.<sup>20</sup> The court, however, found precedent for discovery of privileged medical information in cases applying Ohio law,<sup>21</sup> under which a party does not waive his physician-patient privilege until he actually testifies at trial about his medical condition.<sup>22</sup> In that situation, courts have permitted discovery of relevant yet legally privileged information in anticipation of the patient's testimony so as not to disrupt the trial for discovery at the point the patient testifies and waives his privilege. The Ohio cases, however, authorize pre-waiver discovery only where the waiver is quite likely and only to the extent that the information sought is relevant.<sup>23</sup> The approach chosen by the Indiana court, however,

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20. 521 N.E.2d at 707. The court stated it seemed "ridiculous" at first glance to permit the discovering party to receive the disputed materials in order to argue that the party is entitled to discover the material. *Id.*

21. *Urseth v. City of Dayton*, 653 F. Supp. 1057 (S.D. Ohio 1986); *Huzjack v. United States*, 118 F.R.D. 61 (N.D. Ohio 1987).

22. OHIO REV. CODE ANN. § 2317.02 (Anderson 1981), provides in pertinent part: The following persons shall not testify in certain respects:

\* \* \*

(B) A physician concerning a communication made to him by his patient in that relation or his advice to his patient, except that the physician may testify by express consent of the patient, if the patient is deceased, by the express consent of the surviving spouse or the executor or administrator of the estate of the deceased patient and except that, if the patient voluntarily testifies or is deemed by section 2151.421 (2151.42.1) of the Revised Code to have waived any testimonial privilege under this division, the physician may be compelled to testify on the same subject, or if the patient, his executor or administrator, files a medical claim, as defined in division (D)(3) of section 2305.11 of the Revised Code, the filing shall constitute a waiver of this privilege with regard to the care and treatment of which complaint is made.

23. Neither *Urseth* nor *Huzjack* contemplated wide-open discovery so that the trial court would receive the benefit of counsel and expert testimony in determining which medical information was properly discoverable. In *Urseth*, the court seemed to contemplate inquiry into (1) the decedent's hearing loss, which both sides agreed was relevant to the events leading to the decedent's death, and (2) other aspects of the decedent's medical condition insofar as they related to the decedent's life expectancy. 653 F. Supp. at 1065. In *Huzjak*, the discovering party sought only information regarding the plaintiff's medical condition while a patient in 1983, which information was relevant to the subject matter of the lawsuit. The court expressly stated that inquiry into privileged medical communications would be permitted "subject to . . . the rules of discovery," which made clear

permits discovery of medical information, privileged and non-privileged, whenever a party's medical or mental condition is in issue. Only later does the court determine, with the assistance of counsel and expert witnesses, which pieces of information are irrelevant and privileged and should not have been disclosed in the first place.

The court insisted that its approach adequately respected the interests served by the physician-patient privilege because the privilege is designed to prevent only "public" disclosure of physician-patient confidences, and disclosures made in the course of discovery are not "public."<sup>24</sup> Physicians and patients, however, would be surprised to learn that compulsory disclosure of confidential communications concerning sensitive medical matters to litigants pursuing discovery is not a betrayal of the patient's trust and confidence. Judges would not tolerate open-ended discovery of attorney-client confidences on the ground that such disclosures are not really "public." It is not clear why similar concern should not be shown for confidential physician-patient communications.

Fortunately, there is an alternative to the discovery of privileged medical information which adequately addresses the court's concern regarding the technical and difficult nature of medical material. That is to permit the trial court to inspect disputed medical materials with the assistance of a court-appointed medical expert to ascertain the relevance of the materials to the issues being litigated. Trial courts have authority under Trial Rule 26(C) to fashion "any order which justice requires" to protect litigants from unreasonable discovery requests, including the power to order that discovery be had only on specified terms and conditions. Further, Trial Rule 35 empowers courts to order parties or persons to submit to physical or mental examinations whenever their physical or mental conditions are in controversy, which would appear to incorporate the lesser power of compelling the individual to submit his medical records to a court-appointed expert for examination. The expert could be chosen by the parties and compensated by the court as an element of the costs of the litigation. The point is that trial courts need not resort to open-ended discovery of privileged medical information whenever resolution of the relevance issue is difficult. Rather, courts may make the relevance determination *in camera* in consultation with a court-appointed expert.

## II. PRIVILEGED PEER REVIEW COMMITTEE COMMUNICATIONS

An integral part of the Indiana statutory scheme for quality control of the medical profession is the "peer review committee," the mechanism

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that the physician in question was not expected to disclose irrelevant information. 118 F.R.D. at 66.

24. 521 N.E.2d at 707 (quoting *Collins v. Bair*, 256 Ind. 230, 236, 268 N.E.2d 95, 98 (1971)).



by which doctors and other health-care professionals police their ranks.<sup>25</sup> Peer review committees may be established by the professional staff of any Indiana hospital and have responsibility to review the quality of patient care and the qualifications of staff members. Because the medical community is extremely self-protective, Indiana law provides that all communications to a peer review committee shall be privileged.<sup>26</sup> Except in cases of required disclosure to a health-care provider under investigation, no communication of a peer review committee may be subject to discovery or admitted into evidence in any judicial or administrative proceeding without a written waiver by the committee.<sup>27</sup>

The confidentiality of peer review committee communications is designed to foster open and honest review of the conduct of physicians and other health-care providers. But absolute confidentiality may have other unintended consequences. The statute grants immunity from suit to any peer review committee member, or anyone else who provides a committee with information, provided that such individuals act in "good faith."<sup>28</sup> Unless peer review communications are subject to discovery,

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25. IND. CODE §§ 16-10-1-6.5, 34-4-12.6-1 to -5 (1988).

26. *Id.* § 34-4-12.6-2(a) provides:

All proceedings of a peer review committee shall be confidential, and all communications to a peer review committee shall be privileged communications to the peer review committee. Neither the personnel of a peer review committee nor any participant in a proceeding therein shall reveal any content of communications to, or the records or determination of, a peer review committee outside the peer committee. However, the governing board of a hospital or professional health care organization may disclose the final action taken with regard to a professional health care provider without violating the provisions of this section. Except as otherwise provided in this chapter, no person who was in attendance at any such peer review committee proceeding shall be permitted or required to disclose any information acquired in connection with or in the course of such proceeding, or to disclose any opinion, recommendation, or evaluation of the committee or of any member thereof. Information otherwise discoverable or admissible from original sources is not to be construed as immune from discovery or use in any proceeding merely because it was presented during proceedings before such peer review committee, nor is a member, employee or agent of such committee or other person appearing before it to be prevented from testifying as to matters within his knowledge and in accordance with the other provisions of this chapter, but the witness cannot be questioned about this testimony or other proceedings before such committee or about opinions formed by him as a result of committee hearings.

27. *Id.* § 34-4-12.6-2(c).

28. *Id.* § 34-4-12.6-3 provides:

(a) There shall be no liability on the part of, and no action of any nature shall arise against, the personnel of a peer review committee for any act, statement made in the confines of the committee, or proceeding thereof made in good faith in regard to evaluation of patient care as that term is defined and limited

the good faith requirement would be difficult, if not impossible, to enforce. Physicians whose hospital staff privileges are limited or terminated for illegitimate reasons will find it difficult or impossible to establish that fact since the basis of a peer review committee's decision is inadmissible in evidence. And medical tort victims, who know better than anyone the degree of difficulty involved in persuading medical experts to provide evidence against a fellow medical professional, will be unable to use peer review investigations in establishing their claims. More importantly, tort victims will be unable to play any oversight role in the peer review committee system by holding committee members accountable when they wilfully or fraudulently fail to act against deficient health-care providers.

In three recent opinions, the Indiana Court of Appeals has held that the confidentiality of peer review communications is not subordinated by any of the foregoing concerns. In *Parkview Memorial Hospital, Inc. v. Pepple*,<sup>29</sup> the court held that the statutory privilege for peer review committee communications means just what it says, and that such communications may not be used in evidence by a physician challenging a private hospital's denial of surgical privileges. Judge Garrard filed a concurring opinion pointing out the possibility of conflict between the peer review committee privilege and the right of a physician to challenge a hospital in court over its decision limiting the physician's staff privileges.<sup>30</sup> A later opinion in the same case,<sup>31</sup> however, made clear that physicians have no right to challenge a credentials decision made by a private hospital on the ground that the decision was arbitrary and capricious.<sup>32</sup>

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in section 1(b) [IND. CODE § 34-4-12.6-1(b)] of this chapter.

(b) Notwithstanding any other law, a peer review committee, an organization, or any other person who, in good faith and as a witness or in some other capacity, furnishes records, information, or assistance to a peer review committee that is engaged in: (1) the evaluation of the qualifications, competence, or professional conduct of a professional health care provider; or (2) the evaluation of patient care; is immune from any civil action arising from the furnishing of the records, information, or assistance, unless the person knowingly furnishes false records or information.

(c) The personnel of a peer review committee shall be immune from any civil action arising from any determination made in good faith in regard to evaluation of patient care as that term is defined and limited in section 1(b) of this chapter.

(d) No restraining order or injunction shall be issued against a peer review committee or any of the personnel thereof to interfere with the proper functions of the committee acting in good faith in regard to evaluation of patient care as that term is defined and limited in section 1(b) of this chapter.

29. 483 N.E.2d 469 (Ind. Ct. App. 1985).

30. *Id.* at 470.

31. *Pepple v. Parkview Mem. Hosp., Inc.*, 511 N.E.2d 467 (Ind. Ct. App. 1987) (construing IND. CODE § 34-4-12.6-4 (1988)).

32. 511 N.E.2d at 469.



That opinion further held that a statutory provision permitting the use of peer review information "for legitimate internal business purposes," including a health-care provider's own defense, does not afford aggrieved physicians the right to use privileged communications for the purpose of suing for the reinstatement of staff privileges.<sup>33</sup> A third opinion, *Terre Haute Regional Hospital, Inc. v. Basden*,<sup>34</sup> held that a patient suing a private hospital for fraud in connection with a staff physician's malpractice has no right to discover peer review committee communications concerning the physician. The fact that the legislature limited civil immunity for peer review committee members to actions taken in good faith did not constitute a limitation on the confidentiality and privilege extended to peer review proceedings, determinations and materials. The court acknowledged that the privilege could not be invoked to shield criminal conduct or fraud, but the discovering party must first make a *prima facie* showing that a crime or fraud occurred before a confidential communication will lose its privilege protection.<sup>35</sup>

Collectively, the opinions suggest that the peer review committee privilege is virtually ironclad. Aggrieved physicians and medical malpractice plaintiffs will have to look elsewhere, possibly in vain, for evidence to support claims that the peer review committee system has broken down. All three opinions, however, involved private hospitals. Different results arguably would be reached in cases concerning public hospitals since constitutional due process considerations would be implicated. The court of appeals acknowledged that credentials decisions involving physicians at public hospitals would be subject to judicial review to determine whether the decisions were arbitrary or capricious.<sup>36</sup> Such review would seem to require some disclosure of peer review committee communications in court.

### III. OTHER PRIVILEGES

#### A. Attorney-Client Communication

In *Indiana State Highway Commission v. Morris*,<sup>37</sup> Chief Justice Shepard wrote in a concurring opinion that confidential communications by state agency employees to the Attorney General qualify for the attorney-client privilege and are not subject to compulsory disclosure.<sup>38</sup>

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33. *Id.*

34. 524 N.E.2d 1306 (Ind. Ct. App. 1988).

35. *Id.* at 1310 (plaintiff had merely asserted the existence of fraud, which was insufficient to preclude application of the privilege).

36. *Pepple v. Parkview Mem. Hosp., Inc.*, 511 N.E.2d at 469 n.2.

37. 528 N.E.2d 468 (Ind. 1988).

38. *Id.* at 475 (Shepard, C.J., concurring).

The case involved a negligence claim against the Indiana State Highway Commission arising from an automobile accident on a state bridge. The Supreme Court held that the plaintiff's claim was not barred by the plaintiff's failure to serve notices of the tort claim on both the state agency and the Attorney General, as required by Indiana's Tort Claims Act.<sup>39</sup> The plaintiff's notice was properly served upon a highway commission employee, who acknowledged during discovery that he had made copies and forwarded them to the Attorney General. The Indiana Supreme Court held that the employee's transmittal satisfied the statute's dual notice requirement.<sup>40</sup>

The rationale underlying the attorney-client privilege is that clients must be assured that confidences shared with an attorney will not be revealed so that the attorney will be fully advised in serving the client.<sup>41</sup> Chief Justice Shepard wrote in his concurrence that the rationale applies as forcefully to state agency clients as to private clients. Accordingly, the fact that a highway commission employee forwarded a tort claims notice to the Attorney General was privileged information that need not have been disclosed to the plaintiffs.<sup>42</sup>

### B. Husband-Wife Privilege

In *Baggett v. State*,<sup>43</sup> the defendant's former wife testified as to conversations involving child molestations by the defendant with two girls, ages twelve and eight. The defendant's attorney did not object to the admissibility of the ex-wife's testimony, which the court of appeals held was "clearly" protected by the spousal communications privilege. The court held that the defendant was entitled to a new trial in light of his trial counsel's deficiency in failing to object.<sup>44</sup> The Indiana Supreme Court thereafter granted transfer and vacated the court of appeals opinion, holding that the spousal communications privilege is not a ground for excluding evidence resulting from a report of a child who may have been a victim of abuse or neglect.<sup>45</sup>

In *Kindred v. State*,<sup>46</sup> the Indiana Supreme Court elaborated on the spousal communications privilege, holding that the privilege applies not

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39. *Id.* at 470-71. IND. CODE § 34-4-16.5-6 (1982) provides in pertinent part: "Except as provided in [IND. CODE § 34-4-16.5-8] a claim against the state is barred unless notice is filed with the attorney general and the state agency involved within one hundred eighty (180) days after the loss occurs.

40. 528 N.E.2d at 471.

41. *Id.* at 474 (Shepard, C.J., concurring).

42. *Id.*

43. 507 N.E.2d 637 (Ind. Ct. App. 1987), *vacated*, 514 N.E.2d 1244 (Ind. 1987).

44. 507 N.E.2d at 640.

45. *Baggett*, 514 N.E.2d at 1245.

46. 524 N.E.2d 279 (Ind. 1988).



only to utterances but to communicative acts where there is "some indication [that] the communicating spouse invite[s] the other's presence or attention"<sup>47</sup> and manifests some intent "to communicate the knowledge imparted by the act. When circumstances indicate the communicating spouse is indifferent to the presence of the other, the privilege [would] be inapplicable as it would do nothing to promote its purpose."<sup>48</sup> Accordingly, in this check forgery case, the trial judge properly excluded testimony by the defendant's wife that he had given her cash and a bank book to hide during a police search since the defendant obviously communicated to her a request that the materials be concealed. The trial judge, however, properly admitted the wife's testimony that the bank book contained her husband's handwriting since no confidential communicative act was involved in the wife's examination of the bank book after her husband's arrest.<sup>49</sup>

### C. Self-Analysis Privilege

In *Scroggins v. Uniden Corp. of America*,<sup>50</sup> the court confronted the discoverability of a manufacturer's self-evaluation prepared in compliance with the Federal Consumer Product Safety Act. The Act requires manufacturers to report to the federal government defects in goods that would create a substantial hazard.<sup>51</sup> In *Scroggins*, the plaintiff sought discovery by interrogatories of communications between the Consumer Product Safety Commission and Uniden, the manufacturer of a cordless telephone which the plaintiff claimed caused a loss of hearing when it rang unexpectedly in his ear.<sup>52</sup>

The self-analysis privilege was discussed recently in *Roberts v. Carrier Corp.*,<sup>53</sup> where the court recognized such a common-law privilege under the following standards: (1) to be privileged, the materials in question must have been prepared for mandatory government reports; (2) the privilege extends only to subjective, evaluative materials; (3) the privilege does not extend to objective data in the same reports, and (4) discovery of privileged self-analysis reports is denied only where the policy favoring exclusion clearly outweighs the discovering party's requirements for the information.<sup>54</sup> The public policy behind the privilege is (1) to assure

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47. *Id.* at 296.

48. *Id.*

49. *Id.* at 294-96.

50. 506 N.E.2d 83 (Ind. Ct. App. 1987).

51. 15 U.S.C. §§ 2051-83.

52. 506 N.E.2d at 84.

53. 107 F.R.D. 678 (N.D. Ind. 1985).

54. *Id.* at 684 (citing *Resnick v. American Dental Assoc.*, 95 F.R.D. 372, 374 (N.D. Ill. 1982)).

fairness to persons required by law to engage in self-evaluation and (2) to make the self-evaluation process more effective by creating an effective incentive structure for candid and unrestrained self-evaluation. Thus, the privilege protects only those evaluations that the law requires one to make. An evaluation made voluntarily, in a document not required by the government or not produced for the government, is not privileged.<sup>55</sup>

Notwithstanding *Roberts*, the Indiana Court of Appeals in *Scroggins* rejected the self-analysis privilege because the privilege was not provided by any statute.<sup>56</sup> Creation of privileges is "the sole power of the legislature," and accordingly no self-analysis privilege exists under Indiana law.<sup>57</sup> Further, the court was unpersuaded that a self-analysis privilege fostered any important public policy. Manufacturers will either file honest consumer product safety reports which disclose hazardous products, in which case the government will order production to cease or the manufacturer on its own will cease production; or manufacturers will irresponsibly file reports which misrepresent the existence of hazards. In either case, the court was unpersuaded that a self-analysis privilege would make an appreciable difference in the safety of consumer products.<sup>58</sup>

#### IV. CONCLUSION

The law of privilege in Indiana remains a multi-faceted body of rules, which vary depending upon the policy served by the privilege in question. Privileges will continue to be narrowly construed to foster discovery and the full exchange of all relevant information between litigants. The peer review committee privilege, however, is a dramatic exception to this general state of affairs. The present indication from the Indiana Court of Appeals is that the peer review committee privilege, at least, will receive great deference and may prove to be an absolute bar to the discovery and admissibility of confidential peer review communications.

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55. 107 F.R.D. at 684.

56. 506 N.E.2d 83, 85-86 (Ind. Ct. App. 1987).

57. *Id.* at 86.

58. *Id.*





# Recent Developments Affecting the Criminal Procedure in Indiana

MONICA FOSTER\*

This Article covers criminal cases decided between September 1987 and September 1988 which impact criminal procedure in Indiana. The Article focuses primarily on cases from the Indiana Supreme and Appellate Courts but also includes United States Supreme Court and Seventh Circuit Court of Appeals cases where cases from those courts alter existing state court precedent.

## I. PRETRIAL ISSUES

### A. Amendment of Charges

In *Brooks v. State*,<sup>1</sup> the court was confronted with the issue of whether a person could be convicted of an offense with which the person had not been charged. Brooks was originally charged with Class C child molesting (deviate conduct).<sup>2</sup> At the close of the state's case, the trial court granted judgment on the evidence.<sup>3</sup>

However, the trial court then submitted instructions to the jury on the offenses of attempted child molesting (deviate conduct), a Class C Felony and child molesting (fondling), a Class D Felony.<sup>4</sup> Brooks was convicted of the Class D fondling charge.<sup>5</sup> No objection was made by the defendant to the submission of the additional charges<sup>6</sup> nor was the issue raised in the motion to correct errors.<sup>7</sup>

The court of appeals, in a two to one decision, held that fondling was not a lesser included offense of child molesting (deviate conduct)

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\* Attorney at Law, private practice in Indianapolis, Indiana. B.S., State University of New York, College at Buffalo, 1979; J.D., Indiana University School of Law—Indianapolis, 1983. The author maintains a private law practice devoted exclusively to criminal defense. She is a member of the Marion County Pauper Appeal Panel and a death penalty consultant to the Indiana Public Defender Council. The author gratefully acknowledges the use of resources of the Indiana Public Defender Council which were utilized in determining the choice of cases included in this Article.

1. 526 N.E.2d 1171 (Ind. 1988).

2. *Id.* at 1172.

3. *Id.*

4. *Id.*

5. *Id.*

6. *Brooks v. State*, 518 N.E.2d 1109, 1110 (Ind. Ct. App.), *vacated*, 526 N.E.2d 1171 (Ind. 1988).

7. 526 N.E.2d at 1172.



with which Brooks was charged.<sup>8</sup> However, the court then held that Brooks had waived the error by failing to object and that the error was not fundamental.<sup>9</sup>

The supreme court granted transfer and in a unanimous decision reversed Brooks' conviction holding that Brooks was convicted of an offense for which he was not charged and that the error was fundamental.<sup>10</sup> The court also found that the trial court had exceeded its authority by instructing the jury on offenses not charged where the state failed to amend the charges.<sup>11</sup> The supreme court reiterated that trial courts have no jurisdiction to bring criminal charges or to amend them.<sup>12</sup>

### B. Discovery

1. *Notice of Rebuttal Witnesses.*—The most significant case concerning discovery in Indiana this year is *Mauricio v. Duckworth*,<sup>13</sup> a case decided by the United States Court of Appeals for the Seventh Circuit. In *Mauricio*, the defendant filed a motion for discovery requesting the names, addresses, and prior statements of all witnesses the state intended to call at trial.<sup>14</sup> The state filed a similar motion and additionally requested disclosure of any defenses Mauricio intended to use.<sup>15</sup> Mauricio responded by filing a notice of alibi defense and list of witnesses. After two motions requesting sanctions, the state responded with a list of fifty-nine potential witnesses. The state's witness list did not include the name of a person they intended to call as a rebuttal witness if Mauricio presented an alibi defense.<sup>16</sup>

Mauricio moved to strike the testimony of this witness or, in the alternative, for a mistrial.<sup>17</sup> The trial court denied these motions and Mauricio was convicted of aiding an attempted robbery and felony murder.<sup>18</sup> The Indiana Supreme Court affirmed Mauricio's conviction,<sup>19</sup> adhering to its previously established rule that the names of rebuttal witnesses need not be provided.<sup>20</sup> Further, the court held that there was

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8. 518 N.E.2d at 1110.

9. *Id.*

10. 526 N.E.2d at 1171-72.

11. *Id.* at 1172.

12. *Id.*

13. 840 F.2d 454 (7th Cir. 1988).

14. *Id.* at 456.

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.* at 455.

19. *Mauricio v. State*, 476 N.E.2d 88 (Ind. 1985).

20. *Id.* at 94 (citing *Smith v. State*, 439 N.E.2d 634 (Ind. 1982); *Tillman v. State*, 274 Ind. 39, 408 N.E.2d 1250 (1980)).

no clear record of a request for discovery by the defendant nor proof that there was a request for a continuance when the testimony was offered.<sup>21</sup> Absent such a showing the Indiana court held that the defendant had failed to show an abuse of discretion in allowing the rebuttal witness to testify.<sup>22</sup>

On appeal from the denial of habeas corpus relief, the United States Court of Appeals for the Seventh Circuit determined that the failure of the state to divulge the identity of the rebuttal witness constituted a due process violation which was not harmless.<sup>23</sup> To require a defendant to reveal the particulars of his alibi defense, without giving him an equal opportunity to discover the state's rebuttal witnesses, constitutes a due process violation.<sup>24</sup>

Indiana's alibi statute,<sup>25</sup> does not require that the defendant list witnesses who will support the alibi nor does it require the state to list witnesses who will rebut the alibi.<sup>26</sup> However, "the trial court's discovery order requiring the defense to list *all* its witnesses should have triggered a corresponding and reciprocal obligation on the part of the State to list *all* of its potential witnesses—including likely rebuttal witnesses."<sup>27</sup>

The Seventh Circuit dismissed the state's argument that the defendant was not entitled to relief because he failed to request a continuance.<sup>28</sup> The court found that Mauricio was entitled to an "opportunity *pre-trial* to make a fully informed decision as to whether or not to put on an alibi defense."<sup>29</sup> Concluding that absent the rebuttal witness tainted testimony, the state's case was not overwhelming, the court granted Mauricio *habeas* relief.<sup>30</sup>

*Mauricio* is significant because it overrules that line of cases holding that the state is not required to disclose rebuttal witnesses.<sup>31</sup> The Seventh Circuit opinion is not limited solely to alibi rebuttal witnesses. Discovery must be reciprocal. If the defense is required, by statute, rule or court order, to list all its witnesses, this triggers a reciprocal obligation for the state.

2. *Witness Statements*.—In *State ex. rel. Keaton v. Rush Circuit Court*,<sup>32</sup> a 1985 case, the court held that the prosecutor was not required

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21. 476 N.E.2d at 94.

22. *Id.*

23. 840 F.2d 454 (7th Cir. 1988).

24. 840 F.2d at 457 (citing *Wardius v. Oregon*, 412 U.S. 470 (1973)).

25. IND. CODE § 35-36-4-2 (1988).

26. 840 F.2d at 457.

27. *Id.* (emphasis in original).

28. *Id.* at 458 n.6.

29. *Id.* (emphasis in original).

30. *Id.* at 460.

31. See *supra* note 20.

32. 475 N.E.2d 1146 (Ind. 1985).



to produce verbatim copies of police reports over a timely assertion of the work product privilege. In the 1987 case of *Burns v. State*,<sup>33</sup> the Indiana Supreme Court refused to extend the privilege established in *Keaton* to include the verbatim statements taken pretrial by prosecution authorities of witnesses who had already testified. Once the witness testifies, any prior verbatim statement must be made available to the defense unless the state can demonstrate a paramount interest in non-disclosure.<sup>34</sup> If the state makes such a claim, then the trial court should review the documents *in camera*.<sup>35</sup> However, in *Burns* the documents were not released to the defense, nor did the court conduct an *in camera* review. Therefore, the defendant's right to a fair trial was substantially impaired, requiring a reversal of his conviction.<sup>36</sup>

## II. TRIAL ISSUES

### A. *Alibi Notice*

In *Baxter v. State*,<sup>37</sup> the defendant filed a notice of alibi which was both late<sup>38</sup> and factually inadequate<sup>39</sup> under Indiana Code section 35-36-4-1. As a result, the trial court refused to admit any testimony concerning the alibi, including the testimony of the defendant.<sup>40</sup> A trial court has discretion to permit the filing of a late alibi notice within its discretion for good cause shown.<sup>41</sup>

Initially, the court rejected Baxter's argument that the trial court abused its discretion.<sup>42</sup> Baxter argued that his employer's driving log was the only way he could determine his exact location at the time the offense was alleged to have occurred.<sup>43</sup> Baxter argued that he had inadequate time to procure this log because of his pre-trial incarceration immediately followed by hospitalization and separation from his spouse.<sup>44</sup>

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33. 511 N.E.2d 1052 (Ind. 1987).

34. *Id.* at 1054.

35. *Id.*

36. *Id.*

37. 522 N.E.2d 362 (Ind. 1988).

38. The notice was filed one day prior to the omnibus date. *Id.* at 367. IND. CODE § 35-36-4-1 (1988) requires that notice of alibi be filed twenty days before the omnibus date.

39. The notice stated that he was driving a truck in Pennsylvania. 522 N.E.2d at 367. IND. CODE § 35-36-4-1 (1988) requires that the notice of alibi include "specific information concerning the exact place where the defendant claims to have been."

40. 522 N.E.2d at 367.

41. *Id.*

42. *Id.* at 368.

43. *Id.* at 367.

44. *Id.*

The supreme court held that these explanations did not establish just cause for the delay because no effort was made to obtain the records until two months after Baxter's arraignment and the appellate records does not indicate that Baxter ever acquired the records.<sup>45</sup>

The court then dealt with Baxter's argument that Indiana Code section 35-36-4-1 is unconstitutional because it interferes with a defendant's right to testify. Exclusion of testimony due to noncompliance with the alibi statute is "designed to protect the State from fabrication of defenses and enable prosecutors to prepare adequately for trial."<sup>46</sup> Analysis of whether the defendant's right to testify has been infringed upon is fact-sensitive.<sup>47</sup> The risk of fabrication here was great as evidenced by the ease with which the driving log could be subpoenaed and the failure of Baxter to make such an attempt or make an offer to prove.<sup>48</sup> The state had minimal opportunity to investigate or rebut the vague alibi offered by Baxter.<sup>49</sup> Thus, the court concluded by a four to one<sup>50</sup> margin that Baxter's right to testify did not outweigh the legitimate interests protected by the alibi notice requirement.<sup>51</sup> The court noted, however, that the United States Constitution required at least that the accused be permitted to testify where the defendant's failure to file a timely alibi notice is due to a lack of diligence and the state had sufficient time to investigate and respond.<sup>52</sup>

In *Jennings v. State*,<sup>53</sup> the court was confronted with the effect of the filing of an alibi notice. Jennings was charged with numerous counts of burglary and theft.<sup>54</sup> The state alleged that the offenses occurred on or about September 17, 1981.<sup>55</sup> Jennings filed an alibi notice. In response, the state specified that the alleged offenses occurred between 10:00 p.m. on September 16, 1981, and 6:00 a.m. on September 17, 1981.<sup>56</sup> At trial Jennings presented testimony that he spent the evening with his girlfriend.<sup>57</sup> The jury was given proper instruction concerning alibi but was

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45. *Id.*

46. *Id.* at 369 (citing *Riggs v. State*, 268 Ind. 453, 376 N.E.2d 483 (1978)).

47. 522 N.E.2d at 369.

48. *Id.*

49. *Id.*

50. In his dissenting opinion, Justice DeBruler concluded that the exclusionary sanction of the alibi notice statute may not be used to prohibit the accused from testifying on his own behalf and that the interest of the state in having advance notice of the accused's intent to testify is "small potatoes." *Id.* at 371 (DeBruler, J., dissenting).

51. *Id.* at 369-70.

52. *Id.* at 369.

53. 514 N.E.2d 836 (Ind. 1987).

54. *Id.* at 837.

55. *Id.*

56. *Id.*

57. *Id.*



also instructed that if they found that the crime or crimes were committed by the defendant the state was not required to prove the crimes were committed on the date alleged in the charge.<sup>58</sup> The court in *Jennings* noted that an exception to this rule exists where an alibi defense is mounted.<sup>59</sup> The interjection of an alibi defense makes time "of the essence."<sup>60</sup> The effect of the state's answer to the notice of alibi is to restrict the state to proof of the date in its answer.<sup>61</sup>

Prior case precedent has established that when the state charges a specific date of an offense it may prove that the offense occurred on any date before the charge was filed and within the statute of limitations.<sup>62</sup> The instructions here had the effect of permitting conviction even if the jury believed Jennings' alibi defense, if they found that the offense occurred at a different time than was alleged by the state.<sup>63</sup> This precedent refers to bribery cases and other cases of the type where time is not of the essence—cases unlike this case where instructions served to nullify Jennings' defense of alibi which resulted in the denial of Jennings' right to a fair trial and required reversal.<sup>64</sup>

### B. Judicial Interrogation of Witnesses

The decision of the court of appeals in *Decker v. State*<sup>65</sup> underscores the importance of trial court neutrality. In *Decker*, the court of appeals reversed Decker's conviction because the trial court abandoned its position of impartiality and neutrality. The trial judge questioned a state's witness in a way designed to impeach that portion of the witness' testimony which was favorable to the defendant.<sup>66</sup> Additionally, the trial court advised the witness in the presence of the jury concerning the offense of perjury.<sup>67</sup>

The appellate court noted that a trial judge may properly question a witness in order to clarify the testimony.<sup>68</sup> However, such questioning must be conducted in an impartial manner which does not improperly influence the jury.<sup>69</sup> The questioning at issue here exceeded that stan-

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58. *Id.*

59. *Id.*

60. *Moritz v. State*, 465 N.E.2d 748 (Ind. Ct. App. 1984).

61. 514 N.E.2d at 837.

62. *Id.*

63. *Id.* at 838.

64. *Id.*

65. 515 N.E.2d 1129 (Ind. Ct. App. 1987).

66. *Id.* at 1134.

67. *Id.*

68. *Id.* (citing *Church v. State*, 471 N.E.2d 306, 311 (Ind. 1984)).

69. 515 N.E.2d at 1134 (citing *Kennedy v. State*, 258 Ind. 211, 226, 280 N.E.2d 611, 620 (1972); *Thomas v. State*, 249 Ind. 271, 274-75, 230 N.E.2d 303, 305 (1967)).

dard.<sup>70</sup> The court found that the error prejudiced Decker because of the aura of authority and integrity which juries attribute to trial judges.<sup>71</sup> This required reversal of Decker's convictions even though his attorney failed to object.<sup>72</sup>

The court of appeals reviewed this error in *Decker* in spite of the fact that no specific objection was made at trial.<sup>73</sup> The court was reluctant to apply the waiver doctrine to unobjected incidents of improper judicial intervention because "a fair trial by an impartial judge and jury is an essential element in due process."<sup>74</sup> The court noted further that in this case counsel twice attempted to object and was twice told by the trial judge to be quiet.<sup>75</sup> Not all instances of judicial overreaching will constitute fundamental error but the combination of factors presented by this case was deemed sufficient to overcome the state's waiver argument.<sup>76</sup>

### C. *Entrapment—Admission of Prior Convictions to Show Predisposition*

In *Allen v. State*,<sup>77</sup> a majority of the supreme court held that evidence of the accused's prior convictions is admissible to show predisposition where the defendant has indicated an intent to raise entrapment as a defense in a pre-trial proceeding even though he does not actually raise this defense at trial. The court concluded that it would be "unfair to preclude the prosecution from introducing all evidence relevant to predisposition until the defendant has introduced evidence of entrapment."<sup>78</sup> Justice DeBruler, dissenting, would hold that such evidence is not admissible unless and until the defense raises the entrapment issue, either by presentation of its own evidence or through cross-examination of the state's witnesses.<sup>79</sup> In light of the state's opportunity to present a case in rebuttal and a general judicial desire to avoid interjection of prejudicial extraneous issues, this position seems better reasoned.

In another entrapment case, the United States Supreme Court held that the defendant is not required to admit all elements of an offense in order to be entitled to an instruction on entrapment.<sup>80</sup> In *Mathews*

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70. 515 N.E.2d at 1134.

71. *Id.*

72. *Id.* at 1135.

73. *Id.* at 1131.

74. *Id.* (quoting *Kennedy v. State*, 258 Ind. 211, 218, 280 N.E.2d 611, 615 (1972).

75. 515 N.E.2d at 1132.

76. *Id.*

77. 518 N.E.2d 800 (Ind. 1988).

78. *Id.* at 802.

79. *Id.* at 804-05.

80. *Mathews v. United States*, 108 S. Ct. 883 (1988).



*v. United States*,<sup>81</sup> the accused testified that he committed all acts necessary to constitute the offense but denied that he possessed the requisite *mens rea*.<sup>82</sup> The court held that even if the defendant denies one or more elements of the crime, he is entitled to an entrapment instruction whenever there is sufficient evidence from which a reasonable juror could find entrapment.<sup>83</sup>

#### D. Jury Selection—Racial Discrimination

An area of criminal law that should prove very active in the next few years concerns resolution of issues left unanswered by the landmark decision in *Batson v. Kentucky*.<sup>84</sup> In *Batson*, the United States Supreme Court held that the defendant may make a *prima facie* case of purposeful discrimination in the selection of the petit jury solely on the basis of the prosecutor's exercise of peremptory challenges at the defendant's trial.<sup>85</sup> *Batson* is significant because it overrules *Swain v. Alabama*,<sup>86</sup> a 1965 case which had required a showing that the prosecutor in case after case used peremptories to exclude blacks with the result that no blacks served on petit juries. Indiana had followed the *Swain* rule.<sup>87</sup>

In *Love v. State*,<sup>88</sup> the supreme court remanded the case to the trial court for an evidentiary hearing on whether the prosecutor exercised its peremptory challenges in a racially discriminatory manner. At trial, the prosecutor used peremptory challenges to remove black jurors after cursorily questioning them.<sup>89</sup> Love's counsel objected to this use of peremptories which he alleged was designed to ensure that Love, a black man, was tried before an all white jury.<sup>90</sup> The prosecutor responded that Love had not met his burden under *Swain* because he failed to establish a systematic, intentional pattern of excluding blacks.<sup>91</sup> The court denied Love's motion to strike the jury panel and was subsequently convicted.<sup>92</sup> Shortly after Love was convicted, the United States Supreme Court decided *Batson*.<sup>93</sup> The *Batson* rule applies retroactively to all cases

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81. *Id.*

82. *Id.* at 885.

83. *Id.* at 886.

84. 476 U.S. 79 (1986).

85. *Id.*

86. 380 U.S. 202 (1965).

87. See *Hobson v. State*, 471 N.E.2d 281 (Ind. 1984).

88. 519 N.E.2d 563 (Ind. 1988).

89. *Id.* at 564.

90. *Id.* at 564-65.

91. *Id.* at 565.

92. *Id.*

93. *Id.*

which were not yet final at the time *Batson* was decided.<sup>94</sup> Applying *Batson*, the Indiana Supreme Court found that the prosecutor's questioning of the stricken black venirepersons suggested that they might be partial to the defendant because of their shared race.<sup>95</sup> This suggestion and the removal of all three blacks from the panel point to the possibility of purposeful discrimination.<sup>96</sup> However, the court remanded to the trial court to determine in the first instance, whether the defendant has made a *prima facie* case.<sup>97</sup> If the trial court determines that a *prima facie* case of race discrimination has been established, the prosecutor will then have the burden to come forward with a neutral, nonracial explanation for excusing the black jurors.<sup>98</sup> If the trial court concludes that the jurors were excluded on racial grounds, a new trial should be ordered.<sup>99</sup>

The *Batson* case itself seems to open up more questions than it answers. What sorts of explanations will be deemed sufficiently nonracial to overcome a *prima facie* case? Does the rule in *Batson* apply equally to the prosecutor's assertion that a defense attorney is exercising his peremptories in a racially discriminatory manner?<sup>100</sup> Undoubtedly, *Love* represents the first of a number of cases to address the problem of race discrimination in the selection of petit juries in Indiana.

### III. GUILTY PLEA

#### A. *Protestations of Innocence—Felony Cases*

Over the past year, the appellate courts have created more confusion concerning the status in Indiana of "best interest" pleas. A "best interest" plea is a guilty plea wherein the defendant maintains "innocence but pleads guilty because he has accepted what he considers to be an advantageous bargain."<sup>101</sup> These pleas are accepted in the federal system<sup>102</sup> but have historically constituted reversible error in Indiana.<sup>103</sup>

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94. *Id.* In *Griffith v. Kentucky*, 479 U.S. 314 (1986), the Court held that new rules of law announced by the Supreme Court are to be applied retroactively to all cases which are not yet final at the time the new rule is announced. A case is final when judgment of conviction has been rendered, the availability of appeal exhausted and the time for filing a petition for writ of certiorari has either elapsed or the petition has been finally denied.

95. 519 N.E.2d at 566.

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. *Batson v. Kentucky*, 476 U.S. 79, 90 n.12 (1986).

101. *Bates v. State*, 517 N.E.2d 379, 382 (Ind. 1988).

102. *North Carolina v. Alford*, 400 U.S. 25 (1970).

103. *Ross v. State*, 456 N.E.2d 420 (Ind. 1983); see also *Gary v. State*, 502 N.E.2d 497 (Ind. Ct. App. 1988).



In *Cross v. State*,<sup>104</sup> the appellate court held that Cross' guilty plea must be set aside because after the plea was tendered,<sup>105</sup> Cross denied guilt in an interview with the probation officer who was preparing the presentence investigation report.<sup>106</sup> The court held that in such a situation the trial court is under a duty to initiate a meaningful dialogue with the defendant as to the validity of the guilty plea.<sup>107</sup> Cross' affirmative responses at the guilty plea hearing to the court's "standard inquiry" concerning his desire to plead guilty were not sufficient to override his assertions of innocence made to the probation officer.<sup>108</sup> The appellate court set aside Cross' guilty plea stating that precedent precluded it from accepting defendant's plea when prior to sentencing the defendant claimed to be innocent, even though a sufficient factual basis had been made to which the defendant acceded.<sup>109</sup>

In *Bates v. State*,<sup>110</sup> the defendant pled guilty to unlawful deviate conduct, a Class A Felony. The offense is a Class A Felony when committed by threat of deadly force or use of a deadly weapon.<sup>111</sup> At the guilty plea hearing, Bates refused to admit that he used or threatened to use deadly force or a deadly weapon.<sup>112</sup> The complainant's statement was admitted into evidence at the guilty plea hearing.<sup>113</sup> This statement provided a sufficient factual basis to support the guilty plea.<sup>114</sup> The court upheld Bates' plea even though in tendering it, counsel referred to it as a "best interest" plea and even though Bates refused to admit the force element of the offense.<sup>115</sup> The supreme court found that although Bates never admitted the use of a deadly weapon, he never denied it,<sup>116</sup> and that this was not a sufficient protestation of innocence to make the plea invalid.<sup>117</sup>

In light of *Bates*, it must be concluded that *Cross* was wrongly decided. The state did not petition for rehearing or transfer in *Cross*.

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104. 521 N.E.2d 360 (Ind. Ct. App. 1988).

105. The factual basis required for the plea was presented by the state. Cross indicated that it was correct and declined to add to it. *Id.* at 361.

106. *Id.*

107. *Id.* at 362.

108. *Id.*

109. *Id.* at 363 (citing *Stockey v. State*, 508 N.E.2d 793 (Ind. 1987); *Gibson v. State*, 490 N.E.2d 297 (Ind. 1986)).

110. 517 N.E.2d at 380.

111. IND. CODE § 35-42-4-2 (1988).

112. 517 N.E.2d at 382.

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

*B. Protestations of Innocence—Death Penalty Cases*

A pair of capital cases decided on the same day further muddy the waters surrounding this issue. In *Patton v. State*,<sup>118</sup> the supreme court set aside *sua sponte* Patton's guilty plea and death sentence. At the guilty plea hearing, the court read Patton the charging information which alleged that Patton knowingly killed the victim.<sup>119</sup> Patton admitted the facts as true.<sup>120</sup> At his sentencing hearing, the state sought the death penalty.<sup>121</sup> In order to impose a death sentence in Patton's case, the prosecutor had to prove beyond a reasonable doubt that the killing was intentional.<sup>122</sup> At sentencing, Patton testified that he did not intend to kill the victim.<sup>123</sup> He testified that he shot into the car in which the victim was sitting but that he was unaware that it was occupied.<sup>124</sup>

In setting aside Patton's plea, the court noted that its precedent required such reversal only when the guilty plea and protestation of innocence were simultaneous.<sup>125</sup> However, the court in *Patton* established a new rule for capital cases that a "trial court abuses its discretion when it fails to set aside a guilty plea . . . on its own motion at a capital sentencing hearing when the defendant denies the intent to murder."<sup>126</sup>

In its first opportunity to apply its newly announced rule, the court refused to grant relief to a defendant in a posture that was remarkably similar to *Patton*. In *Van Cleave v. State*,<sup>127</sup> the defendant pled guilty to felony murder. The state sought the death penalty alleging as an aggravating factor that Van Cleave intentionally killed the victim while attempting to commit robbery. At the sentencing hearing, the state presented evidence that the killing was intentional.<sup>128</sup> Van Cleave's mother testified that the killing "was an accident" and that Van Cleave "panicked."<sup>129</sup>

The *Van Cleave* opinion itself does not address any possible distinction between *Van Cleave* and *Patton*. However, in *Patton* the court noted that Van Cleave admitted the crime and contested the aggravating

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118. 517 N.E.2d 374 (Ind. 1987).

119. *Id.* at 375.

120. *Id.*

121. *Id.*

122. *Id.* at 376.

123. *Id.* at 375.

124. *Id.*

125. *Id.* at 376.

126. *Id.*

127. 517 N.E.2d 356 (Ind. 1987).

128. *Id.* at 360-61.

129. *Id.* at 361.



factor.<sup>130</sup> By contrast, the court found that Patton denied the crime charged.<sup>131</sup>

The distinction appears to be that Van Cleave pled guilty to felony murder,<sup>132</sup> which has no mental element, while Patton plead guilty to a "knowing" murder.<sup>133</sup> Thus, when Patton appeared at sentencing and alleged that he didn't realize there were people in the car when he shot into it, he was actually asserting his innocence to the crime for which he had pled guilty. Had Van Cleave's guilty plea been to a "knowing" murder, one can assume that his conviction would also have been set aside.

#### IV. SENTENCING

##### A. *Consecutive Sentences for Multiple Habituals*

In *Starks v. State*,<sup>134</sup> the defendant was separately sentenced on each of eighteen theft convictions. The state filed two allegations of habitual offender status. Starks was sentenced to three years on each of the theft convictions and thirty years on each of the habitual offender counts.<sup>135</sup> The two theft convictions to which the habitual offender allegations were attached were ordered to run consecutively for a total sentence of sixty-six years.<sup>136</sup>

The supreme court held that two habitual offender findings in a single proceeding cannot be ordered to be served consecutively.<sup>137</sup> The basis for the court's holding is the "absence of express statutory authorization for such a tacking of habitual offender sentences . . . ."<sup>138</sup> Apparently, the court was unsatisfied that the provisions of Indiana Code section 35-50-1-2<sup>139</sup> contained such authorization. That statute provides that "the court shall determine whether terms of imprisonment shall be served concurrently or consecutively."<sup>140</sup> The *Starks* court noted that this provision "appears unlimited in scope, applying to the class of all sentences."<sup>141</sup> But the court found that the power to order con-

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130. *Patton*, 517 N.E.2d at 376.

131. *Id.*

132. *Van Cleave*, 517 N.E.2d at 359.

133. *Patton*, 517 N.E.2d at 375.

134. 523 N.E.2d 735 (Ind. 1988).

135. *Id.*

136. *Id.*

137. *Id.* at 737.

138. *Id.*

139. IND. CODE § 35-50-1-2 (1988).

140. 523 N.E.2d at 735-36.

141. *Id.* at 736.

secutive sentences is subject to "the rule of rationality and the limitations in the constitution."<sup>142</sup> The court did not explain how the sentence is either irrational or unconstitutional but, nevertheless, held it to be impermissible to order consecutive sentences in such a situation due to the lack of express statutory authorization.<sup>143</sup>

### *B. Vindictive Sentencing*

In *Flowers v. State*,<sup>144</sup> the defendant was originally convicted of attempted murder for which he received a fifty-year sentence.<sup>145</sup> He also received the presumptive sentence of thirty years for numerous other Class A Felonies of which he was convicted.<sup>146</sup> The court ordered these sentences served consecutively.<sup>147</sup> On appeal, the court instructed the trial court to vacate the Class A convictions and sentences and to enter convictions and appropriate sentences for two Class B Felonies and a Class C Felony.<sup>148</sup>

On remand, the lower court entered the same aggregate sentence of eighty years.<sup>149</sup> The court accomplished this by entering aggravated sentences on the two class B Felonies to be served consecutively to each other and to the sentence for attempted murder.<sup>150</sup> The court also ordered an aggravated sentence on the Class C Felony but ordered that it be served concurrently to all other sentences.<sup>151</sup>

On appeal, Flowers argued that the court could not resentence him to eighty years because he was being sentenced for lesser felonies than those which were the basis for the original eighty-year sentences.<sup>152</sup> The court rejected this argument finding that the trial court properly found aggravating facts to support the increased sentence on remand.<sup>153</sup> The supreme court noted that the trial court used the same aggravating circumstances on remand that it had originally used to aggravate the attempted murder conviction.<sup>154</sup>

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142. *Id.*

143. *Id.* at 737.

144. 518 N.E.2d 1096 (Ind. 1988).

145. *Id.* at 1097 (appellant received a presumptive sentence of thirty years which was enhanced by twenty years because of aggravating circumstances).

146. *Id.*

147. *Id.*

148. *Flowers v. State*, 481 N.E.2d 100, 107 (Ind. 1985).

149. *Flowers*, 518 N.E.2d at 1097.

150. *Id.*

151. *Id.*

152. *Id.* at 1098.

153. *Id.*

154. *Id.*



The supreme court held that the imposition of the eighty-year sentence did not violate the double jeopardy clause of the Fifth Amendment.<sup>155</sup> The court noted that there are certain circumstances in which sentences may be increased on remand.<sup>156</sup> However, those circumstances were irrelevant in Flowers' case because he was not given an increased sentence.<sup>157</sup> Nor does the double jeopardy clause bar the eighty-year sentence because Flowers had already started serving his time.<sup>158</sup> There are many situations in which a sentence may be changed after the defendant begins serving it.<sup>159</sup> One example is when, as here, the defendant attacks the legality of his original sentence.<sup>160</sup> Finding no sentencing error, the court affirmed the trial court's actions.<sup>161</sup>

## V. POST-CONVICTION RELIEF

During the survey period, the supreme and appellate courts continued the trend of making post-conviction relief less available to convicted persons and narrowing the grounds for such relief. In one case, the court held the remedy unavailable to juveniles. In another case, the court held that a petitioner may not raise ineffective assistance of prior post-conviction counsel as a ground for relief in a subsequent post-conviction petition.

### A. *Post-Conviction Relief Not Available to Juveniles*

In *Jordan v. State*,<sup>162</sup> a majority of the supreme court held that state provisions for post-conviction relief are not available to juveniles adjudicated delinquent. The court first noted that the post-conviction rules themselves provide a post-conviction remedy for "any person who has been *convicted* of, or sentenced for, a crime by a court of this State."<sup>163</sup> Juvenile adjudications do not constitute criminal convictions.<sup>164</sup> The juvenile process is civil, not criminal.<sup>165</sup> The nature of the juvenile process is rehabilitation.<sup>166</sup> When a juvenile is found to be delinquent,

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155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.* at 1099.

162. 512 N.E.2d 407 (Ind.), *reh'g denied*, 516 N.E.2d 1054 (Ind. 1987).

163. *Id.* at 408 (quoting IND. R. P. POST-CONVICTION REM. 1, § 1(a) (emphasis added)).

164. 512 N.E.2d at 408 (citing *Pallet v. State*, 269 Ind. 396, 401, 381 N.E.2d 452, 456 (1978)).

165. 512 N.E.2d at 408.

166. *Id.*

a program is attempted to aid the juvenile in rehabilitation.<sup>167</sup> Adjudication of delinquency does not impose any civil disability nor does it disqualify the juvenile from any governmental application, examination or appointment.<sup>168</sup>

In contrast, an adult conviction is a stigma which affects the adult throughout life.<sup>169</sup> It can subject the adult to habitual criminal sentencing provisions.<sup>170</sup> It can affect the adult's credibility as a witness in future trials.<sup>171</sup> In its discussion of the relative legal innocuousness of juvenile adjudications, the court did not address the fact that otherwise suspendible felonies are made nonsuspendible by the fact that the offender has a juvenile record.<sup>172</sup>

Finally, the court noted that the procedure for direct appeal is available for review of juvenile adjudications.<sup>173</sup> Additionally, the juvenile court has discretion to expunge a person's juvenile record.<sup>174</sup> The dissenters expressed concern that some procedure must, as a matter of due process, be available to challenge on legal grounds an adjudication after appeal time has expired.<sup>175</sup> Chief Justice Shepard responded to the dissenters in a concurring opinion to the denial of rehearing and stated his belief that Trial Rule 60<sup>176</sup> could provide an avenue of review in such instances.<sup>177</sup>

### *B. Petitioner's Presence at Hearing*

In *Page v. State*,<sup>178</sup> the court held that the petitioner's presence at the hearing on his post-conviction petition is not required. The right to be present at all critical stages of the proceedings applies only to trial.<sup>179</sup>

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167. *Id.* at 409.

168. *Id.* (quoting IND. CODE ANN. § 31-6-3-5 (Burns 1980)).

169. 512 N.E.2d at 409.

170. *Id.*

171. *Id.*

172. IND. CODE § 35-50-2-2.2(a) (1988) provides that the court may not suspend a sentence for a felony if the person has a juvenile record which includes acts which would constitute the following felonies if committed by an adult:

1 one Class A or Class B Felony;

2 two Class C or Class D Felonies; or

3 one Class C and one Class D Felony; and less than three years have elapsed between commission of the juvenile act(s) and the commission of the felony for which the person is currently being sentenced.

173. 512 N.E.2d at 409.

174. *Id.* at 409-10 (quoting IND. CODE ANN. § 31-6-8-2 (Burns 1980)).

175. 512 N.E.2d at 411 (DeBruler, & Dickson, J. J., dissenting).

176. IND. R. TR. P. 60.

177. *Jordan v. State*, 516 N.E.2d 1054 (Ind. 1987) (Shepard, C.J., concurring).

178. 517 N.E.2d 427 (Ind. App. 1988).

179. *Id.* at 429 (citing *Gallagher v. State*, 466 N.E.2d 1382 (Ind. Ct. App. 1984)).



Here, the facts which supported Page's allegations were not in dispute.<sup>180</sup> Page's affidavit was admitted into evidence at the hearing without objection.<sup>181</sup> Page's presence was not constitutionally required.<sup>182</sup> A post-conviction court does not abuse its discretion when it conducts the post-conviction hearing without the petitioner.<sup>183</sup>

### C. Laches

In *Perry v. State*,<sup>184</sup> Chief Justice Shepard, writing for the majority, clarified the degree of proof required to establish the defense of laches to a post-conviction petition. Post-conviction relief may be pursued at any time.<sup>185</sup> However, the doctrine of laches infers a waiver of the right to challenge a judgment.<sup>186</sup> The elements of laches which the state must prove by a preponderance of the evidence are: (1) that the petitioner unreasonably delayed in seeking relief, and (2) that the state has been prejudiced by the delay.<sup>187</sup> The court concluded that the doctrine of laches may not be predicated upon constructive knowledge, that is, knowledge imputed by operation of law.<sup>188</sup> Nor may laches be imputed to a petitioner by charging him with "inquiry notice," that is, a duty to inquire about the validity of his conviction upon the happening of a certain event such as incarceration.<sup>189</sup> Rather, the court will require the state to prove actual knowledge in order to prevail on a laches defense.<sup>190</sup> However, the state is not required to present direct evidence on this point; circumstantial evidence is sufficient to show state of mind.<sup>191</sup> Facts from which a reasonable factfinder could infer actual knowledge include: the petitioner's "repeated contacts with the criminal justice system, consultation with attorneys and incarceration in a penal institution with legal facilities. . . ."<sup>192</sup> The sufficiency of the showing of laches must be made by the post-conviction court in the first instance.<sup>193</sup>

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180. 517 N.E.2d at 429.

181. *Id.*

182. *Id.*

183. *Id.*

184. 512 N.E.2d 841 (Ind. 1987).

185. *Id.* at 843 (citing IND. R. P. POST-CONVICTION REM. 1, § 1(a)).

186. 512 N.E.2d at 843.

187. *Id.* (citing *Lacy v. State*, 491 N.E.2d 520 (Ind. 1987); *Pinkston v. State*, 479 N.E.2d 79 (Ind. 1985)).

188. 512 N.E.2d at 844.

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.* at 845.

193. *Id.*

Provided there is probative evidence to support its determination, the appellate court will affirm its judgment.<sup>194</sup>

*D. Ineffective Assistance of Post-Conviction Counsel*

In *Alston v. State*,<sup>195</sup> the defendant entered a guilty plea. At his guilty plea hearing, the court neglected to advise him of three of the rights he was waiving by pleading guilty.<sup>196</sup> Alston filed a post-conviction petition but did not allege as error that the court had neglected to advise him of these rights.<sup>197</sup> Clearly, had counsel raised these errors Alston would have prevailed and he would have been granted a new trial.<sup>198</sup> However, after that time, the supreme court held in *White v. State*<sup>199</sup> that when a petitioner alleges the sort of error present in Alston's case, he must show that the omissions made a difference in the defendant's decision to plead guilty. The court denied Alston relief holding that the decision in *White* controlled in his case even though it was his attorney's ineffectiveness which had operated to deny him the relief he was admittedly entitled to when his first petition was filed.<sup>200</sup> In a bitterly worded opinion, the court made much of the fact that Alston never disputed the factual basis for the plea or that he was factually guilty.<sup>201</sup> The court concluded that, if counsel is inadequate at a prior post-conviction proceeding, the remedy is to permit the petitioner to start over.<sup>202</sup> The new proceeding, however, must be determined by prevailing law as if no prior post-conviction petition had been filed.<sup>203</sup>

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194. *Id.*

195. 521 N.E.2d 1331 (Ind. Ct. App. 1988).

196. *Id.* at 1334.

197. *Id.*

198. *Id.*

199. 497 N.E.2d 893 (Ind. 1986).

200. 521 N.E.2d at 1335.

201. *Id.* at 1334.

202. *Id.* at 1335.

203. *Id.*





# Survey of Recent Developments in the Indiana Law of Evidence

NORMAN T. FUNK\*

## I. INTRODUCTION

If the appellate judiciary has been described, facetiously, as students of the law possessing the freedom to grade their own paper, the restraints upon those of us who subsequently review their work are even less. Our views as commentators are essentially made without the benefit, or restraint, of any records of the proceedings at the trial courts which, of course, are the factual essence upon which rest the appellate opinions. We simply do not know what facts, altogether, served to persuade the courts to reach their conclusions, and each reported opinion of the court does not necessarily set forth all of those facts, or necessarily even all of the salient ones, which were persuasive to the courts in ending up with the conclusions and reasoning ultimately expressed in the opinions themselves. We simply have to accept, and work with, the facts as reported in the opinions themselves. We are neither limited by any need to reach a consensus of thinking in reaching the results that we do, nor benefitted by the collective, persuasive thinking of others on the court who share the responsibility of reaching correct and reasoned conclusions. Moreover, we have not had the benefit of the legal authorities and argument which were presented in the appellate process and which influenced the courts' conclusions. In short, the views we offer are essentially our own and, with certain limitations, are not shared by the courts themselves. It is within those limitations, and the potential for error which they represent, that the following is offered as an overview of those cases which are noteworthy involving evidentiary issues under Indiana law during the survey period. The author hopes to assist the judiciary and bar in their understanding and ultimate application of these cases.

## II. HEARSAY

Hearsay evidence received a good deal of appellate consideration during the survey period, not always consistent. Most of that consid-

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\* Principal, Hill, Fulwider, McDowell, Funk & Matthews, Indianapolis, and Member of the International Association of Defense Counsel and Defense Research Institute. B.S., Indiana University, 1967; J.D., Indiana University School of Law—Indianapolis, 1971.



eration focused on the business records exception to the general rule prohibiting introduction of evidence which is otherwise hearsay.

Hearsay evidence was again defined during the survey period, as either testimony in court, or written evidence of a statement or entry made out of court, which is being offered to show the truth of the matters which are asserted therein, and is thus resting for its value upon the credibility of the out-of-court asserter.<sup>1</sup> The general rule, of course, is that such hearsay evidence is inadmissible, because its attempted use, when offered for the truth of the matter, deprives the party against whose interests it is offered the opportunity to challenge its accuracy and therefore its truthfulness. It thereby becomes unreliable, and thus inadmissible, unless falling within one of the recognized exceptions to the hearsay rule, that is, hearsay evidence which is nevertheless admissible because of an established judicial recognition that the hearsay evidence has been sufficiently cleansed by the satisfaction of a particular set of foundational requirements, so that the benefits attendant to the admission of the evidence override the potential for its untrustworthiness.

For the business records exception to override the exclusionary rule prohibiting the admission of hearsay evidence, Indiana law has long recognized that the witness, through whose testimony the hearsay evidence is offered, must satisfy four foundational requirements: (1) the records must be identified *either* by their entrant *or* by one under whose supervision they are kept; (2) the records must be shown to be either an original, or a first permanent entry or a duplicate thereof, made in the regular or routine course of business; (3) the records must be shown to have been made at or near the time of the recorded event or transaction; and (4) the recording must be shown to have been performed or made by a person who had both a duty to record the event or transaction as well as personal knowledge of the event or transaction represented by the entry or the recording.<sup>2</sup> As such, traditional Indiana common law requirements comport with the Federal Rules of Evidence,<sup>3</sup> as well as with the views of authoritative commentators.<sup>4</sup>

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1. *Payne v. State*, 515 N.E.2d 1141 (Ind. Ct. App. 1987). *Accord* *Patterson v. State*, 263 Ind. 55, 324 N.E.2d 482 (1975); *Choate v. State*, 462 N.E.2d 1037 (Ind. Ct. App. 1984).

2. *Jones v. State*, 267 Ind. 205, 209, 369 N.E.2d 418, 420 (1977); *Myers v. State*, 422 N.E.2d 745, 752 (Ind. Ct. App. 1981); *Burger Man, Inc. v. Jordan Paper Prods.*, 170 Ind. App. 295, 308, 352 N.E.2d 821, 830 (1976); *American United Life Ins. Co. v. Peffley*, 158 Ind. App. 29, 36, 301 N.E.2d 651, 656 (1973) (case states that it sets forth "[a] synthesis of the Indiana cases treating what modern authorities call the 'business record' exception to the hearsay rule").

3. FED. R. EVID. 803(6).

4. M. SEIDMAN, *THE LAW OF EVIDENCE IN INDIANA* 135 (1977); E. IMWINKELRIED, *EVIDENTIARY FOUNDATIONS* 171 (1980).

However, in *Wiseman v. State*,<sup>5</sup> decided during the survey period, the Indiana Supreme Court either resurrected or created a fifth requirement which arguably must now be satisfied before the business records exception to the exclusion is satisfied: the witness who had knowledge of the facts contained in the records must be unavailable to testify, or unable to recall the facts so as to testify from memory.<sup>6</sup> Except for a single prior case decided seventeen years earlier, upon which the *Wiseman* court relied in making this additional foundational requirement,<sup>7</sup> the business records exception to the hearsay rule in Indiana simply had not included a requirement similar to *Wiseman* that the witness who had knowledge of the facts contained in the records must be unavailable to testify, or be unable to recall the facts themselves. In fact, the requirements of the business records exception to the hearsay rule were addressed on at least two other occasions by the Indiana Court of Appeals during the survey period.<sup>8</sup> In neither of those contemporaneous cases did either court expressly or impliedly add the *Wiseman* or *Wells* requirement of an "absent or forgetful witness" in order to satisfy the foundational requirements of the business records exception to hearsay.

Nor does the purported additional requirement in *Wiseman* add anything meaningful to enhance the trustworthiness of the evidence which is permitted by the business records exception. It is that enhancement of the trustworthiness of the testimony which is, and should be, the sole justification for establishing the exception in the first instance. The purpose of the exception is to establish a series of adequate foundational requirements which are purposefully created to remove, or minimize, the untrustworthiness of evidence which otherwise is unreliable hearsay, and thereby permit its reasonable use by the trier of fact. The exception has never sought to require the introduction of the best evidence, or the most reliable evidence, or only that evidence which cannot be otherwise established by a witness because that witness is unavailable or unable to recall the facts or assertions contained in out-of-court records or statements. However, it is these evidentiary purposes which the "absent or forgetful witness" requirement of *Wiseman* seems to address. Those

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5. 521 N.E.2d 942 (Ind. 1988).

6. *Id.* at 944.

7. *Wells v. State*, 254 Ind. 608, 261 N.E.2d 865 (1970) (*Wells* was authored by Justice DeBruler, who also authored *Wiseman v. State*, 521 N.E.2d 942 (Ind. 1988)). While *Wells* in fact contains the requirements cited subsequently in *Wiseman* pertaining to the foundational requirements of the business records exception to the hearsay rule, the same misstatement in *Wiseman* was initiated in *Wells*. There should be no requirement that the witness who had knowledge of the facts be unavailable to testify, nor be unable to recall the facts so as to testify from memory.

8. *Payne v. State*, 515 N.E.2d 1141 (Ind. Ct. App. 1987); *Brant Constr. Co. v. Lumen Constr., Inc.*, 515 N.E.2d 868 (Ind. Ct. App. 1987).



purposes have simply never been part of the justification, nor need to be part of the justification, for any exception to the hearsay rule, including the business records exception, and should not be made part of the justification now.

Neither *Payne v. State*<sup>9</sup> nor *Brant Construction Co. v. Lumen Construction, Inc.*,<sup>10</sup> also decided during the survey periods, deviated from the traditional foundational requirements which prior Indiana law held must be satisfied in order to admit business records into evidence which are otherwise hearsay. Both of those decisions followed the traditional requirements, consistent with the foundational requirements earlier established in *Burger Man, Inc. v. Jordan Paper Products, Inc.*,<sup>11</sup> *American United Life Insurance Co. v. Peffley*,<sup>12</sup> *Jones v. State*,<sup>13</sup> *Myers v. State*,<sup>14</sup> and the additional authority cited therein.<sup>15</sup> *Wiseman*, therefore, stands alone during the survey period as authority which purports to either graft a new and additional foundational requirement, or to resurrect the earlier requirement of *Wells v. State*.<sup>16</sup> To require an "absent or forgetful witness" who had knowledge of the facts and the records, in order to permit the introduction of the facts contained in those records through another witness who can otherwise satisfy the traditional foundational requirements, is a requirement which, if in fact intended by the *Wiseman* court, is both unnecessary and improper when considered either from the standpoint of traditional Indiana case law or from the standpoint of the purpose for the existence of the foundational requirements themselves.

If *Wiseman* adds confusion to the status of the business records exception to the hearsay rule, however, *Willis v. State*,<sup>17</sup> clarifies the specificity required in the objection which must be made to the business records when they are offered. In *Willis*, the state offered evidence in its rebuttal case. The defendant "objected to the introduction of the exhibit *on hearsay grounds*."<sup>18</sup> The state's reply to the objection was that the evidence, though hearsay, was nevertheless admissible under the business records exception to the hearsay rule. The supreme court held that the defendant's objection, "on hearsay grounds," was an insufficient

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9. 515 N.E.2d at 1143-44.

10. 515 N.E.2d at 872.

11. 170 Ind. App. 295, 308, 352 N.E.2d 821, 830 (1976).

12. 158 Ind. App. 29, 36, 301 N.E.2d 651, 656 (1973).

13. 267 Ind. 205, 209, 369 N.E.2d 418, 420 (1977).

14. 422 N.E.2d 745, 752 (Ind. Ct. App. 1981).

15. See *supra* notes 2, 11-14.

16. 254 Ind. 608, 261 N.E.2d 865 (1970).

17. 510 N.E.2d 1354 (Ind. 1987), *cert. denied*, 108 S. Ct. 721 (1988).

18. *Id.* at 1357 (emphasis added).

objection.<sup>19</sup> Citing the long-established rule that evidentiary objections must be specific, and not general, to preserve error for judicial review on appeal, the court held that the proper and necessary objection would have been to object on the basis of "insufficient foundation," and not merely "on hearsay grounds."<sup>20</sup>

The reasoning of the court is interesting. Had the objection been specific and not general, that is, stated on the grounds of insufficient foundation instead of on the grounds of hearsay, the court explained that the state then would have been furnished with a fair opportunity to correct the deficiency in the offered evidence by satisfying the necessary foundational requirements which had not been fulfilled when the evidence was offered and the objection was made.<sup>21</sup> The court seems to say that at least a purpose of the requirement that objections to offered evidence be specific is to permit the party offering that evidence to then proceed to correct that deficiency in order to enable the proffered evidence to ultimately be received. If that is in fact part of the court's reasoning, then the purpose for making the objection is not merely to exclude evidence, but simultaneously to instruct the party proffering that evidence as to the exact deficiencies in the evidentiary offer itself in order that the deficiencies can then be corrected and the previously excluded evidence be successfully reoffered. The objection, under *Willis*, must not merely be specifically adversarial, but instructive, as well.<sup>22</sup> Moreover, the reason that the evidence in *Willis* was inadmissible was because that evidence truly was hearsay. Although a sufficient foundation in fact may not have been established to satisfy the appropriate exception to the rule prohibiting the introduction of the hearsay evidence, the evidence itself remained hearsay and it was the nature of that evidence, as hearsay, which explained why it should not have been received and considered by the trier of fact. The insufficient foundation was a failure to cleanse the untrustworthy, hearsay character of the evidence; the uncleansed evidence itself, therefore, remained hearsay, and thus inadmissible, and objecting to its admissibility on the basis that the evidence was hearsay should have been sufficient. The *Willis* court held that it was not, however, and the lesson from the case, therefore, is that an objection to hearsay evidence, when offered, must be based not only "upon hearsay grounds," but also upon a failure to establish a proper foundation to satisfy the applicable exception to the hearsay rule itself.<sup>23</sup> Any objection short of that is insufficient under the ruling in *Willis*.

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19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*



In *Payne v. State*,<sup>24</sup> the court again addressed the business records exception. In this case, statements had been made *by the patient* in hospital records concerning the alleged causes of her injuries. Although noting that medical records themselves are generally admissible under the business records exception to the hearsay rule, citing *Fendley v. Ford*,<sup>25</sup> the court noted that "any facts within a medical history *given by the patient* are not admissible as substantive evidence."<sup>26</sup> The court concluded that statements contained in the medical records which are made by the patient, and which concern the alleged cause of her injuries were not within the exception to the hearsay rule and could not have been admitted as substantive evidence.<sup>27</sup>

A different aspect of hearsay was addressed by the court of appeals in *Senff v. Estate of Levi*.<sup>28</sup> In *Senff*, a paternity action was brought against the estate of the putative father. During trial, the child's mother attempted to testify concerning her relationship with the putative father during his lifetime, in order to establish paternity. The estate objected to that testimony on the basis of the Indiana Dead Man's Statute, which renders a witness incompetent when the following requirements are met:

- (a) The action must be one in which an administrator or executor is a party, or one of the parties is acting in the capacity of an administrator or executor;
- (b) The action must involve matters which occurred within and during the lifetime of the decedent;
- (c) The action must be a case in which a judgment or allowance may be made or rendered for or against the estate represented by such executor or administrator;

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24. 515 N.E.2d 1141 (Ind. Ct. App. 1987).

25. 458 N.E.2d 1167 (Ind. Ct. App. 1984).

26. *Payne*, 515 N.E.2d at 1144. In *Fendley*, 458 N.E.2d at 1170-72, Judge Shields has provided an excellent discussion of whether the results of certain medical tests, including blood-alcohol tests, which are described or memorialized in hospital records may be admissible under the business records exception to the hearsay rule. As discussed therein, other jurisdictions permit certain test results to be admitted into evidence through the hospital records, without testimony from the witnesses who performed the tests, on the basis that the tests themselves are sufficiently routine that the results may be considered as "fact" and not opinion. At least with respect to the results of blood-alcohol tests, Indiana has not adopted that rule, and the results of blood-alcohol tests are not admissible into evidence, as "mere facts," even if included in the hospital records which are otherwise offered into evidence upon the satisfaction of the foundational requirements to establish the business records exception to the hearsay rule. See also *Hayes v. State*, 514 N.E.2d 332 (Ind. Ct. App. 1987), also decided during the survey period, on the degree of testimony required to satisfy the foundational requirements for the admission of the test results.

27. *Payne*, 515 N.E.2d at 1144.

28. 515 N.E.2d 556 (Ind. Ct. App. 1987).

- (d) The witness must be a necessary party to the issue and not merely a party to the record; and
- (e) The witness must be adverse to the estate and must testify against the estate.<sup>29</sup>

The court of appeals first held that the trial court had committed error in applying the Dead Man's Statute to prevent the child's mother from testifying concerning her relationship with the putative father during his lifetime.<sup>30</sup> The court reasoned, and properly so, that the child's mother possessed no interest adverse to the estate; the paternity petition was brought by the mother on behalf of the minor child, and it was the child who was the real party in interest and the person intended to be benefited by the establishment of paternity.<sup>31</sup> The mother was only a nominal party, and the mere fact that she brought the action in a representative capacity on behalf of the child, did not rightfully render her a party with an adverse interest against the estate within the meaning of the Dead Man's Statute.<sup>32</sup>

During trial in *Senff*, another witness attempted to testify concerning a conversation which she had had with the putative father shortly before his death. The estate objected on the grounds of hearsay, which was sustained. The argument made in favor of admitting into evidence those statements made by the putative father to that witness, was that the testimony was admissible as an admission, even if it was hearsay.<sup>33</sup> The court of appeals agreed, and held that the decedent's statements were admissible as admissions, and distinguished an admission from a hearsay statement.<sup>34</sup> "An admission," the court held, "is a statement against the interests of a party which is inconsistent with a defense or tends to establish or disprove a material fact."<sup>35</sup> The court then concluded that the subsequent death of a party who has made such an admission does not render that admission inadmissible.<sup>36</sup>

In *Kline v. Business Press, Inc.*,<sup>37</sup> the court of appeals considered the application, and potential extension, of that Indiana hearsay rule

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29. IND. CODE § 34-1-14-6 (1982).

30. *Senff*, 515 N.E.2d at 559.

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.* Because the child's mother failed to make an offer to prove, however, an axiomatic requirement when an objection is sustained to a question asked on direct examination, the court of appeals concluded the error in excluding the putative father's admission had not been preserved for appeal, and the court therefore did not reverse on that basis.

36. *Id.* (citing *Uebelhack Equip., Inc. v. Garrett Bros., Inc.*, 408 N.E.2d 136 (Ind. Ct. App. 1980); 12 IND. L. ENCYC. *Evidence* § 131 (1959)).

37. 516 N.E.2d 88 (Ind. Ct. App. 1987).



which has become commonly known as "the *Patterson* rule," previously established by the Indiana Supreme Court in *Patterson v. State*.<sup>38</sup> In *Kline*, hearsay statements had been included within affidavits tendered in support of dispositive motions. The affidavits stated that the affiants "had heard" another nonparty witness make certain statements, and those statements were offered in the affidavits for the truth of the matters contained in the statements.<sup>39</sup> A deposition had been taken of the declarants who had allegedly made the statements reported in the affidavits, but not of the affiants themselves. After restating the axioms that facts and matters set forth in affidavits must be admissible in evidence in order to be properly considered by a court when ruling on Summary Judgment Motions, and that courts must ignore those parts of affidavits which are not admissible evidence, the court of appeals in *Kline* concluded that the statements which were contained in the affidavit were in fact hearsay, that they were offered as proof of the truth of the facts contained therein, and that they were therefore inadmissible.<sup>40</sup>

In *Kline*, the party which sought to use the hearsay affidavits argued that, although hearsay, the affidavits nevertheless presented admissible evidence under the exception to the hearsay rule which had been previously enunciated by the Indiana Supreme Court in *Patterson v. State*. In *Patterson*, as reviewed by the *Kline* court, two witnesses had given out-of-court statements prior to trial. Both witnesses were thereafter called to testify as in-court witnesses. Their out-of-court statements were offered and received into evidence, and were consistent with their in-court testimony.<sup>41</sup> The *Patterson* court had then held that the out-of-court statements, although hearsay, were nevertheless admissible as substantive evidence because the declarants themselves were on the stand, under oath, and subject to cross-examination at the time their pre-trial statements were offered into evidence.<sup>42</sup>

The *Kline* court concluded that *Patterson* could not apply so as to render the Summary Judgment Affidavits admissible hearsay.<sup>43</sup> It was true that the persons who allegedly made the statements which had been reported and contained within the affidavits had been deposed; arguably, therefore, the requirement of *Patterson* which compelled the declarant to be available "for cross-examination," by deposition if not necessarily at trial, was satisfied.<sup>44</sup> The *Kline* court, however, correctly observed

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38. 263 Ind. 55, 324 N.E.2d 482 (1975).

39. *Kline*, 516 N.E.2d at 91.

40. *Id.*

41. *Patterson*, 324 N.E.2d at 484-85.

42. *Id.*

43. *Kline*, 516 N.E.2d at 92.

44. *Id.*

that the persons who were transmitting, or relaying, the out-of-court statements, that is, the affiants themselves who furnished the affidavits, had not been deposed and therefore it could not be determined that the statements made by the affiants in their own depositions were consistent with their subsequent statements in the affidavits.<sup>45</sup> *Kline* properly recognized that a comparison could be made between the sworn deposition testimony given by the original declarants, and the subsequent out-of-court statements made by those same declarants whose comments were reported by the affiants in the affidavits. Therefore, the consistency between those two statements could be confirmed in order to satisfy the *Patterson* requirement that the statements made by the declarant/witness on both occasions be consistent. However, the court also properly recognized that there could be no comparable compliance with the same requirement insofar as the statements of the *affiants* were concerned—that is, the relayer of the original declarations.<sup>46</sup> Mindful of the instructions of the Indiana Supreme Court in *Samuels v. State*<sup>47</sup> and in *Stone v. State*<sup>48</sup> not to extend the *Patterson* rule, the *Kline* court concluded that *Patterson* could not apply, that the affidavits were hearsay, and that there was no basis to prevent their being stricken.<sup>49</sup> The summary judgment which the trial court had granted over the stricken affidavits asserted in opposition was therefore upheld.

Finally, on the subject of hearsay, the court of appeals in *Lafary v. Lafary*<sup>50</sup> considered an issue which had not been considered in Indiana in excess of one hundred years: whether specific statements made in a contract, although made out of court and by an out-of-court declarant, are nevertheless admissible. In *Lafary v. Lafary*, an oral contract had been made between the defendant and his deceased father. The defendant attempted to testify at trial concerning the substance of that contract. The trial court sustained “an objection to the testimony as hearsay.”<sup>51</sup> The court of appeals reversed, and held that

“[w]here the *utterances of specific words* is itself a part of the details of the issue under the substantive law and the pleadings,

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45. *Id.*

46. *See id.*

47. 267 Ind. 676, 372 N.E.2d 1186 (1978).

48. 268 Ind. 672, 377 N.E.2d 1372 (1978).

49. *Kline*, 516 N.E.2d at 92.

50. 522 N.E.2d 916 (Ind. Ct. App. 1988).

51. *Id.* at 917. Presumably, under *Willis v. State*, 510 N.E.2d 1354 (Ind. 1987), the objection which was made in *Lafary* to have been properly sustained would have included insufficient foundation as a basis for the objection. Otherwise, *Willis* would have made the objection “on hearsay grounds” insufficient. 510 N.E.2d at 1357. *See supra* text accompanying notes 17-23.



their utterances may be proved without violation of the hearsay rule, because they are not offered to evidence the truth of the matter that may be asserted therein. . . . The *making of a contract* necessarily involves utterances . . . and these are admissible under the issue.<sup>52</sup>

The court thus stated that the statements made within the contract, and which constituted the contract itself, were thus part of the contract and thereby not hearsay. The oral, contractual statements, therefore, became admissible.<sup>53</sup>

### III. EXPERT TESTIMONY

The suitability, sufficiency, and foundational requirements for expert testimony were also considered several times during the survey period by Indiana courts, with most of that consideration arising in the context of malpractice litigation.<sup>54</sup>

In *Burke v. Capello*,<sup>55</sup> a medical malpractice action, the Indiana Supreme Court was presented with a summary judgment motion which had been granted by the trial court in favor of a physician who had performed hip surgery upon the plaintiff. Several weeks following surgery upon examination precipitated by pain, it was discovered that fragments of cement measuring a total of one inch in diameter, which had been used during surgery to affix a prosthesis, had been left in the wound.<sup>56</sup> The physician, who had been sued on the basis that the cement had been left in the wound, filed a Motion for Summary Judgment and, in support thereof, submitted the written expert opinion of the Medical Review Panel finding in favor of the physician.<sup>57</sup> The opinion of the Panel had concluded that there was no malpractice in accordance with the Medical Malpractice Act.<sup>58</sup> Specifically, the Medical Review Panel had concluded that the evidence did not support the conclusion that the physician had failed to meet the appropriate standard of care, and he thereby had not committed an act of negligence.<sup>59</sup> Additional evidence

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52. 522 N.E.2d at 917 (quoting 6 J. WIGMORE, WIGMORE ON EVIDENCE § 1770 (Chadbourn rev. 1981)).

53. 522 N.E.2d at 917.

54. Outside of the area of malpractice litigation, the Indiana Court of Appeals also held during the survey period that obscenity, to be proven, need not have expert testimony and may be based upon the jury's viewing of the materials. *VanSant v. State*, 523 N.E.2d 229 (Ind. Ct. App. 1988).

55. 520 N.E.2d 439 (Ind. 1988).

56. *Id.* at 440.

57. *Id.* at 441.

58. See IND. CODE § 16-9.5-9-7 (1982).

59. *Burke*, 520 N.E.2d at 441.

submitted in support of the Motion for Summary Judgment detailed the care with which the surgical procedure had been performed, including the physician's own assertion therein that "care was taken to remove extraneous cement . . . ." <sup>60</sup> The patient offered no evidence in the summary judgment proceedings to contradict the opinion of the Medical Review Panel or the additional evidence which had been submitted in support of the summary judgment. <sup>61</sup>

The Indiana Supreme Court, with Justice Dickson dissenting in a separate opinion, reversed an unpublished opinion of the court of appeals, and set aside the summary judgment. The supreme court found that although expert testimony is ordinarily necessary in medical malpractice actions because of the general rule requiring expert testimony in matters of a technical and complex nature, the leaving of a foreign object in the body "which should have been removed by an act understandable by the jury without extensive technical input" was the kind of act which in fact needed no expert testimony in order to establish a *prima facie* case of negligence. <sup>62</sup> In reaching its conclusion, the court reasoned that "[t]he properties of liquid cement are common knowledge," a conclusion by the supreme court which presumably was based upon evidence contained somewhere in the record of proceedings or which otherwise would arguably be an invasion by the supreme court into the province of the trier of fact. <sup>63</sup> What is, or is not, common knowledge presumably was

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60. *Id.*

61. *Id.*

62. *Id.* As a threshold consideration, there must always be established a need for the expert testimony before that testimony may be given. The issues to be addressed by the expert testimony must be such that they lie beyond the ordinary knowledge of the trier of fact, whether jury or court, and the trier of fact, therefore, could only indulge in speculation in reaching the findings on those issues if expert testimony were not provided. Such testimony is not appropriate with respect to matters which are within the common experience, observation, or knowledge of the trier of fact. *Noblesville Casting Div. of TRW, Inc. v. Prince*, 438 N.E.2d 722 (Ind. Ct. App. 1982); *Johnson v. Bender*, 174 Ind. App. 638, 369 N.E.2d 936 (1977). Expert testimony should be excluded where the trier of fact is as well qualified to form an opinion upon the facts as is the expert witness. *Hill v. State*, 470 N.E.2d 1332 (Ind. 1984); *Reburn v. State*, 421 N.E.2d 604 (Ind. 1981); *Breese v. State*, 449 N.E.2d 1098 (Ind. Ct. App. 1983); *Carter v. State*, 412 N.E.2d 825 (Ind. Ct. App. 1980). However, in *Summers v. State*, 495 N.E.2d 799 (Ind. Ct. App. 1986), the court, citing an interpretation of FED. R. EVID. 702 in 3 J. WEINSTEIN & M. BERGER, *WEINSTEIN'S EVIDENCE* § 702(02) (1985), allowed expert testimony upon a finding that the expert's opinions would be helpful to the jury, even though the jury may have been able to make a determination without that testimony. And yet, *Summers*, defined an expert as "one who, by reason of education or special experience, has knowledge concerning a subject matter about which persons who have no particular training are incapable of forming an accurate opinion or making a correct decision." *Summers*, 495 N.E.2d at 802. See also *Moody v. State*, 448 N.E.2d 660 (Ind. 1983).

63. *Burke*, 520 N.E.2d at 441.



established somewhere in the record of proceedings, either by judicial notice or otherwise, however, there is nothing in the reported opinion indicating that judicial notice provided the evidentiary basis for establishment of those facts. In fact, the reported opinion indicates that the patient had presented no evidence whatsoever in opposition to this Motion for Summary Judgment, and presumably the affidavits which had been presented on behalf of the defendant did not set forth any self-incriminating evidence concerning "the properties of liquid cement," or that such properties "are common knowledge" to laymen generally.<sup>64</sup> In short, the basis upon which the supreme court derived this evidence of "common knowledge" is unclear, unless it was established in the record of proceeding. The court then reasoned that a "rational trier of fact could have inferred from the admissible evidence that the cement would have been in at least a hardening state and thus perceptible by sight or touch to a careful observer engaged in the process of cleansing the wound . . . ."<sup>65</sup> Therefore, the court concluded, "[t]he inference of breach of duty confronts medical opinion of no breach of duty," and a genuine issue of material fact was thereby created which would render summary judgment inappropriate.<sup>66</sup> The trial court's granting of the summary judgment was thus reversed.

During the survey period, the court of appeals also considered the question of what degree of certitude an expert's opinion must express in order to be admissible, as well as the related question of what degree of exactness tests and experiments must have in order to be reliable as a basis for expert testimony. In *Yang v. Stafford*,<sup>67</sup> a medical malpractice action, opinions of an expert witness were contained in a sworn affidavit which was considered as part of a summary judgment proceeding. The affidavit failed to include any explanation as to the degree of certitude with which the opinions contained therein were being expressed, and specifically failed to explain that the opinions which were being made were based upon a reasonable degree of medical certainty.<sup>68</sup> The parties against whose interests the affidavits were submitted then challenged their use on that basis.<sup>69</sup> The court of appeals disagreed with the challengers, and properly distinguished what are matters of evidentiary foundation, on the one hand, from others, which are matters of the degree of weight which should be placed upon that testimony once it is admitted. "[T]he admissibility of a physician's testimony should not be determined

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64. *Id.*

65. *Id.*

66. *Id.* at 442.

67. 515 N.E.2d 1157 (Ind. Ct. App. 1987).

68. *Id.* at 1162.

69. *Id.*

by examining the level of certainty in his opinions," the court reasoned, "since the court would be invading the province of the jury."<sup>70</sup> The court continued:

Therefore, the admissibility of a physician's testimony should not be determined by examining the level of certainty in his opinions since the court would be invading the province of the jury. Rather, the expert's opinion is admissible if 'a proper foundation establishes the need for expert testimony and the expert's credentials establish an expertise in the area and the methods employed. . . .' Once these factors are established, the evidence is admissible and the jury is left to perform its function of assessing the reliability of the evidence.<sup>71</sup>

*Yang* thereby becomes part of the growing progeny of *Noblesville Casting Division of TRW, Inc. v. Prince*.<sup>72</sup> Prior to *Noblesville Casting*, Indiana law had permitted medical expert testimony only if the conclusions and opinions expressed by such experts were given in testimony couched in terms of reasonable medical certainty; expert testimony that a certain proposition would merely be possible, as opposed to reasonably certain, was inadmissible.<sup>73</sup> In *Noblesville Casting*, however, the requirement of the previous law was expressly reversed. The *Noblesville Casting* court held that expert testimony, to be admissible, need not be expressed in any particular degree of certitude, because such a requirement improperly emphasizes semantics of the testimony rather than the trustworthiness of its substance and thus its reasonable use by the trier of fact.<sup>74</sup> What must be "reasonably certain," under *Noblesville Casting*, is not what words are chosen for the expression of the opinion, but

that the witness is in fact an expert and that the analytical and scientific methods employed are generally accepted in the particular community of expertise; in other words, "reasonable certainty" is primarily a formulation designed to guarantee the trustworthiness or reliability of the opinion offered, rather than the fact to be proved.<sup>75</sup>

In *Yang*, as earlier in *Noblesville Casting*, the rule then becomes that the issue of admissibility is not determined by the language which is employed in the expression of the opinion; rather, the admissibility is

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70. *Id.*

71. *Id.* (quoting *Kaminski v. Cooper*, 508 N.E.2d 29, 30 (Ind. Ct. App. 1987)).

72. 438 N.E.2d 722 (Ind. 1982).

73. *Palace Bar, Inc. v. Fearnot*, 269 Ind. 405, 381 N.E.2d 858 (1978).

74. *Noblesville Casting*, 438 N.E.2d at 728.

75. *Id.* at 729.



determined by whether the expert witness is shown to have sufficient credentials to enable him to provide opinions on the issues on which he is expected to testify, and whether the methods, tests, and other assistance he has utilized in reaching his opinions are established as reasonably reliable.<sup>76</sup> If those foundational requirements are satisfied, then the degree of certitude with which those opinions are expressed, whether "possibility," "probability," "certainty," or some other comparative expression, become subject to an ultimate determination by the trier of fact after consideration of all of the evidence presented on the subject.<sup>77</sup>

Similarly, in *Hayes v. State*,<sup>78</sup> the court held that test results which are considered by an expert witness in giving expert testimony must be reasonably reliable, although not necessarily fail-safe. In *Hayes v. State*, the technical accuracy of a blood-alcohol test was challenged; arguably, a certain amount of ethanol may have developed in the blood sample, which in turn may have affected the reliability of the test results.<sup>79</sup> The court held, and properly so, that the results of the test were nevertheless admissible, even though arguably tainted by technical imperfections. The court reasoned that "[t]he persuasiveness of such evidence is in large measure dependent upon the expertise of the witness who conducted it; in the final analysis, this is to be determined by the jury after an opportunity for cross-examination."<sup>80</sup> The foundational requirements, therefore, are: whether the test is of a kind ordinarily performed to provide the purported analysis; whether the test is generally reliable; and whether the credentials of the expert witness who will be interpreting the results of the test have been adequately established.

*Hayes* also addressed the foundational prerequisites for admitting fungible evidence, including blood samples, and the interpretation of the results thereof.<sup>81</sup> The *Hayes* court reviewed applicable authority as follows:

The admissibility of fungible evidence such as blood samples depends upon a foundation which establishes, inter alia, a continuous chain of custody. The purpose of the rule requiring the State to show a continuous chain of custody of fungible evidence is to demonstrate that there has been no tampering, loss, substitution, or mistake with respect to the evidence. Thus the

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76. *Yang*, 515 N.E.2d at 1161.

77. *Id.* at 1162.

78. 514 N.E.2d 332 (Ind. Ct. App. 1987).

79. *Id.*

80. *Id.* at 338.

81. *Id.* at 337.

foundation is required to connect the exhibit with the defendant and show the continuous whereabouts of the exhibit from the time it comes into the possession of the police until it is laboratory tested.<sup>82</sup>

Although the requisite chain of custody was established, the defendant objected to the introduction of the test results because of the absence of any testimony that the containers into which the blood samples had been placed were clean; the defendant argued if they were not, a possibility existed that the test sample was contaminated and the test results thereby unreliable.<sup>83</sup> The court rejected that argument. The mere possibility that evidence might have been tampered with or contaminated will not by itself render that evidence inadmissible.<sup>84</sup> In *Hayes*, there was no evidence that contamination had in fact occurred; the objection was only that the lack of contamination, that is, the negative, had occurred, and under *Conrad v. State*<sup>85</sup> and *Zimmerman v. State*<sup>86</sup> there need be no conclusive proof of the negative.<sup>87</sup>

In *Hayes*, there apparently had been no testimony by a physician, or someone in authority who was present at the time of the taking of the specimen, to establish the condition of the equipment utilized for the sampling and the procedures which were followed.<sup>88</sup> Citing *Orr v. State*,<sup>89</sup> the defendant asserted "that the State must elicit testimony *from* a doctor or someone in authority who was present at the time of the taking of the blood as to the procedure used in that taking."<sup>90</sup> The court disagreed, and, citing *King v. State*,<sup>91</sup> held that the foundational requirement to admit the test results does in fact require testimony to be elicited *about* a physician or someone in authority, to establish *who* was present at the time of taking and *what* was done, but that the foundational testimony need not come *from* the physician or the other person who either took the sample or was present at the time.<sup>92</sup> The foundational testimony, therefore, is sufficient if it comes from any witness who was present when the sample was taken and who is otherwise

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82. *Id.* (citations omitted).

83. *Id.* at 336.

84. *Id.* at 337 (citing *Zimmerman v. State*, 469 N.E.2d 11 (Ind. 1984)); *Conrad v. State*, 262 Ind. 446, 317 N.E.2d (1974).

85. 262 Ind. 446, 317 N.E.2d 789 (1974).

86. 469 N.E.2d 11 (Ind. 1984).

87. *Hayes*, 514 N.E.2d at 337.

88. *Id.* at 336.

89. 472 N.E.2d 627 (Ind. Ct. App. 1984).

90. *Hayes*, 514 N.E.2d at 337.

91. 397 N.E.2d 1260 (Ind. Ct. App. 1979).

92. *Hayes*, 514 N.E.2d at 337.



competent to testify as to what a physician or other qualified person did, and did not do, with respect to the sampling and identification procedures.

In another medical malpractice action, *Wilson v. Sligar*,<sup>93</sup> the court of appeals again addressed the general Indiana rule which prevents an expert witness from testifying as to the applicable standard of care unless it is first established that the expert is in fact familiar with the standard of care in the same or similar locality as the one in which the alleged act or acts of negligence occurred. The standard of care thereby is measured with reference to the same or similar locality as that in which the complained-of acts were performed.

The court in *Wilson* reviewed the historical justification for the "same or similar locality" rule, noting that the "rule was intended to prevent the inequity that would result from holding rural doctors to the same standard of care as urban doctors."<sup>94</sup> And, the court explained the purpose of Indiana's adherence to the rule, as ensuring that "the physician's professional conduct will be judged in light of the conditions and facilities with which he must work."<sup>95</sup> In a possible portent for future consideration of the "same or similar locality" rule, however, the court, in a footnote, observed that the "same or similar locality" rule is currently being challenged with respect to those physicians, and presumably other professionals who are sued for malpractice, who have become nationally board certified specialists. The court observed:

We note that today even the less stringent "same or similar locality" rule is under attack with regard to nationally board certified specialists. A national standard of care appears to be justified for specialists who are nationally certified, who have equal access to new theories and modern facilities, and who are equally able to refine their procedures. However, regardless of the merit of changing the standard for specialists to a national standard of care, as an intermediate appellate tribunal this Court is not at liberty to depart from the standard of care embodied in our supreme court's precedent. Therefore, this court will apply the "same or similar locality" rule to the specialist in the present case.<sup>96</sup>

It will be up to the supreme court to accept the invitation of *Wilson v. Sligar* to give future consideration to the foundational requirement

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93. 516 N.E.2d 1099 (Ind. Ct. App. 1988).

94. *Id.* at 1101.

95. *Id.*

96. *Id.* (citations omitted).

of whether expert testimony in medical malpractice litigation, may be given only if the witness is first shown to be familiar with the prevailing standards applicable to the same or similar locality as that in which the defendant committed the acts complained of, in those instances in which the defendant is nationally certified or has otherwise complied with national standards of competence.

#### IV. IMPEACHMENT AND EVIDENCE OF OTHER CRIMES AND CHARGES

The Indiana courts also considered several cases during the survey period concerning impeachment, evidence of other crimes, and the application in a civil proceeding of evidence of criminal misconduct or the lack thereof.

Generally, evidence of one crime is not admissible to prove that another crime was committed.<sup>97</sup> However, evidence of the earlier crime having been committed may be admissible to prove commission of a subsequent crime by the same perpetrator, if a foundation of substantial similarity between the two crimes can be established.<sup>98</sup> To satisfy that foundation, the facts of the two crimes must be shown to be so similar, unusual, or distinctive as to create a probability that both crimes were committed by a common perpetrator.<sup>99</sup> The application of the foregoing rule was considered during the survey period in *Henley v. State*.<sup>100</sup> In *Henley*, the defendant was convicted of multiple offenses, including rape. During trial, the state introduced evidence that eight days prior to the alleged rape, the defendant had seriously assaulted another witness.<sup>101</sup> The defendant objected, arguing that the two attacks were not so distinctive or unique as to make them a "signature," and that the similarities, if any, were merely common to most rapes and therefore would not suggest a common plan or identity.<sup>102</sup> The court of appeals disagreed, and held that the evidentiary foundation had been established by a showing that there were sufficient similarities between the two crimes that a trier of fact could properly conclude that it *was likely* that the defendant had in fact committed both crimes.<sup>103</sup>

In *Hatcher v. State*,<sup>104</sup> the Indiana Court of Appeals again addressed the issue of whether evidence of prior offenses by an accused is admissible,

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97. *Hobbs v. State*, 466 N.E.2d 729 (Ind. 1984); *Kimmel v. State*, 275 Ind. 575, 418 N.E.2d 1152, *cert. denied*, 454 U.S. 932 (1981).

98. *Hobbs*, 466 N.E.2d at 733; *Kimmel*, 275 Ind. at 518, 418 N.E.2d at 1154.

99. *Hobbs*, 466 N.E.2d at 733.

100. 522 N.E.2d 376 (Ind. 1988).

101. *Id.* at 379.

102. *Id.*

103. *Id.* at 379-80.

104. 510 N.E.2d 184 (Ind. Ct. App. 1987).



if it is relevant, to show the likelihood of the commission of the subsequent crime. Specifically, the court was faced with the depraved sexual instinct exception previously addressed by the Indiana Supreme Court in *Kuchel v. State*<sup>105</sup> and *Kerlin v. State*.<sup>106</sup> Those cases held that evidence of prior offenses by the accused are not admissible if they are produced merely to show the defendant's bad character or to show that the defendant has a tendency to commit certain types of crimes, *unless* the alleged crime involves a depraved sexual instinct.<sup>107</sup> If the crime alleged in fact does involve a depraved sexual instinct, then under *Kuchel*, evidence of the prior offenses which involved that same instinct become admissible.<sup>108</sup> In *Hatcher v. State*,<sup>109</sup> the court affirmed the depraved sexual instinct exception to the general rule which otherwise excludes evidence of prior offenses of an accused.

Although evidence of prior crimes committed by a defendant generally are inadmissible to prove the commission of a subsequent crime, evidence of previous criminal conduct generally is admissible for impeachment purposes. The convictions, however, must be one or more of those infamous crimes set forth in *Ashton v. Anderson*,<sup>110</sup> or other crimes involving dishonesty or false statement. Drug convictions had previously been held to be inadmissible for impeachment purposes, because they generally fell beyond the enumerated crimes under the *Ashton* rule.<sup>111</sup> However, in *Wilson v. State*,<sup>112</sup> decided during the survey period, the court held that evidence of a prior drug conviction could be used for impeachment purposes, because on direct examination the defendant had denied any prior convictions "of several types of crimes including the crime he was charged with."<sup>113</sup> The supreme court held that the defendant had thus "opened the door" with his direct testimony concerning what crimes he had *not* been convicted of, thus effectively placing his character into issue as he was attempting to present himself as a person of good character and thereby a person unlikely to have committed the charged crime.<sup>114</sup> Accordingly, the court reasoned, his prior convictions of any

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105. 501 N.E.2d 1032 (Ind. 1986).

106. 255 Ind. 420, 265 N.E.2d 22 (1970).

107. *Kuchel*, 501 N.E.2d at 1033; *Kerlin*, 255 Ind. at 424, 265 N.E.2d at 25.

108. *Kuchel*, 501 N.E.2d at 1033.

109. 510 N.E.2d 184 (Ind. Ct. App. 1987).

110. 258 Ind. 51, 279 N.E.2d 210 (1972) (the crimes were identified as: treason, murder, rape, arson, burglary, robbery, kidnapping, forgery, and willfull and corrupt perjury).

111. *Hatchett v. State*, 503 N.E.2d 398 (Ind. 1987); *Jones v. State*, 512 N.E.2d 211, 214 n.3 (Ind. Ct. App. 1987).

112. 521 N.E.2d 363 (Ind. Ct. App. 1988).

113. *Id.* at 367.

114. *Id.* at 368.

of the other crimes enumerated in *Ashton* could be used for impeachment purposes, as well as his prior conviction on drug-related charges.<sup>115</sup>

The final case included within this review is *Schneider v. Wilson*,<sup>116</sup> a legal malpractice action. In *Schneider*, the plaintiff had been operating a truck, which was struck at a railroad crossing by a train engine. The plaintiff then brought suit against the railroad. A blood sample obtained from the plaintiff shortly after the accident, however, revealed a blood alcohol level of .16%, a violation of Indiana Code section 9-11-1-7 which provides that evidence of .10% or more, by weight of alcohol in blood, constitutes *prima facie* evidence of intoxication.<sup>117</sup> Because of various alleged acts of legal malpractice, the plaintiff's claim in the underlying case was involuntarily dismissed, and a malpractice action subsequently was brought which rested upon the involuntary dismissal of the underlying case.<sup>118</sup> In the legal malpractice action, the trial court granted summary judgment in favor of the defendant on the basis that the plaintiff had been operating his vehicle while intoxicated in the underlying case and that he was, therefore, contributorily negligent as a matter of law.<sup>119</sup> The malpractice defendant had successfully argued that because of his contributory negligence, the plaintiff could not have recovered in the underlying action, even had it been properly prosecuted, and the subsequent malpractice action therefore could not be successfully maintained.<sup>120</sup>

The court of appeals reversed the trial court's summary judgment in the malpractice action, and held that although there was no dispute that the plaintiff had been operating his vehicle with a blood alcohol level of .16%, that fact constituted only *prima facie* evidence of intoxication while driving his truck, and "this presumption may be rebutted by the fact that Schneider was never charged with driving while intoxicated and his statement that he was not drunk. The lack of such charge, after investigation by the police, creates an inference that Schneider may not have violated that Statute."<sup>121</sup> Without question, Schneider should have been able to rebut the clinical evidence of his intoxication by his own testimony that he was not drunk by his own testimony or that of others that he was not impaired at that time and place, or by similar testimony

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115. *Id.*

116. 521 N.E.2d 1342 (Ind. Ct. App. 1988).

117. *Id.* IND. CODE § 9-11-1-7 (1988) provides: "Prima facie evidence of intoxication" includes evidence that at the time of an alleged violation there was ten hundredths percent (.10%), or more, by weight of alcohol in the person's blood."

118. *Schneider*, 521 N.E.2d at 1343.

119. *Id.*

120. *Id.*

121. *Id.* at 1344.



that he was capable of safely and properly operating his vehicle at the time of the accident.

However, it is submitted that there is not persuasive legal precedent for the court to have suggested that evidence that Schneider had never been charged with driving while intoxicated would be admissible at trial and, in fact, prevailing Indiana law should exclude that very kind of evidence. Criminal conduct which does not result in a conviction is generally inadmissible.<sup>122</sup> Moreover, the mere fact that a criminal charge has been made against a witness, which is not followed by a conviction on that charge, is not relevant.<sup>123</sup> Likewise, conviction of a crime in a criminal case upon facts which serve as the basis for bringing a civil action as well is inadmissible to establish any element of the civil action.<sup>124</sup> Even a guilty plea to the criminal action which was based upon facts giving rise to the civil suit is only some evidence of culpability in the civil action as an admission, but is not necessarily conclusive of fault in the civil litigation.<sup>125</sup> The common thread through these cases is that a mere charge, without conviction, is evidence of nothing and that a conviction in a criminal case is not evidence of wrongdoing in a civil action brought on the same facts.

*Schneider* is factually distinguishable to the extent that the evidence of a criminal "no-charge" was to be used to establish a civil "no-fault" rather than evidence of a criminal conviction being used to establish civil fault.<sup>126</sup> Nevertheless, *Schneider* contradicts the principles which derive from this series of cases and does so unjustifiably. *Schneider* would let a mere accusation by the state, or lack thereof, become evidentiary in nature in the civil proceeding. There may have been any number of reasons why the state elected not to charge Schneider with the criminal offense of driving while intoxicated, having little if anything to do with the results of the blood-alcohol testing, and a trier of fact would be compelled to speculate as to the reasons for which that charge was not brought. What the state chooses to do with evidence, that is, whether the state elects to proceed with prosecution or instead chooses to forebear from that course, should not be relevant either on the issue of whether the evidence exists or on the issue of the proper interpretation to be placed upon that evidence when it is considered within the context of civil litigation. Notwithstanding the contrary rule expressed in *Schneider*, the fact that a civil litigant has *not* been criminally *charged*, when

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122. Robinson v. State, 525 N.E.2d 605 (Ind. 1988); Jarvis v. State, 441 N.E.2d 1 (Ind. 1982).

123. Jones v. State, 512 N.E.2d 211, 214 n.3 (Ind. Ct. App. 1987).

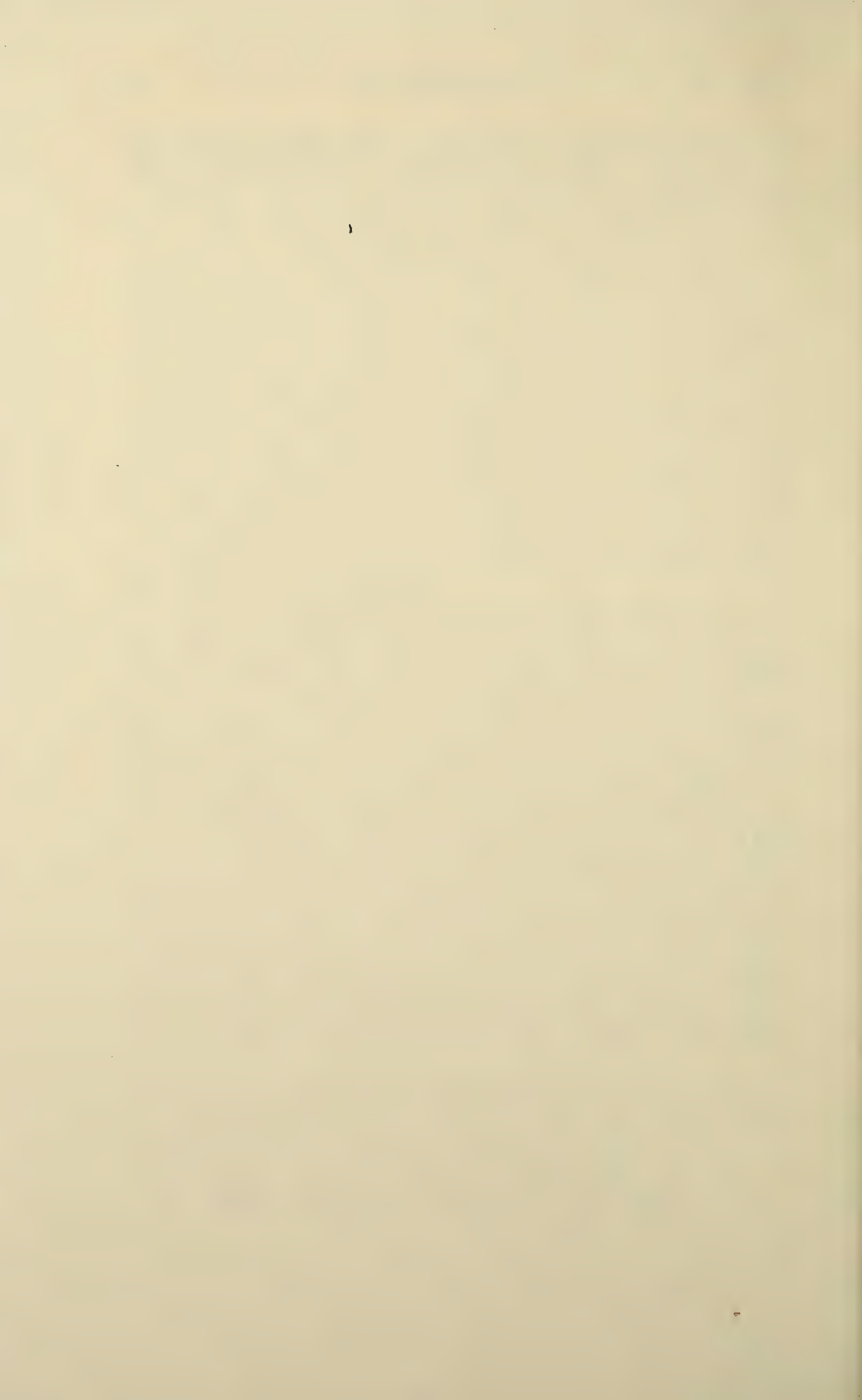
124. Cromer v. Sefton, 471 N.E.2d 700 (Ind. Ct. App. 1984).

125. Shearer v. Cantrell, 145 Ind. App. 693, 252 N.E.2d 514 (1969).

126. Schneider v. Wilson, 521 N.E.2d 1341 (Ind. Ct. App. 1988).

the same facts serve as the basis for the civil offense as well as the criminal offense, should not be admissible as substantive evidence in the civil proceeding.





# The New Indiana Child Support Guidelines

GALE M. PHELPS\*

Jerald L. Miller\*\*

## I. INTRODUCTION

The Child Support Enforcement Amendments of 1984<sup>1</sup> require all states to adopt formulas for child support awards by October 1, 1987. Guidelines are to be available to all judges and other officials with the authority to establish child support awards but are not necessarily binding upon them.<sup>2</sup> The implementation of these guidelines is expected to improve both the adequacy and the equity of court orders relating to child support. Guidelines based upon sound economic evidence allow child support to reflect realistically the actual cost of raising children.

Child support guidelines have the force of law in some states but not in others. Indiana falls in the latter category.<sup>3</sup> Different methods used to implement state guidelines include statutory enactments,<sup>4</sup> court rules,<sup>5</sup>

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\* Partner, Phelps & Fara, Indianapolis. B.A., Butler University, 1969; J.D., Indiana University School of Law—Indianapolis, 1976.

\*\* Partner, Boberschmidt, Miller, O'Bryan & Turner, P.A., Indianapolis. B.S., Ball State University, 1965; J.D., Indiana University, 1973.

1. Pub. L. No. 98-378, 98 Stat. 1305, 1321-22 (*codified at* 42 U.S.C. § 667).

2. 42 U.S.C. § 667(b) (Supp. III 1986), 45 C.F.R. § 302.56(b) (1987). The choice of the word "Guidelines" reflects an intent to establish a formula or a quantitative standard for setting child support rather than criteria.

3. JUDICIAL REFORM COMM., JUDICIAL CONFERENCE OF INDIANA, CHILD SUPPORT GUIDELINES 2 (2d ed. 1988). [hereinafter *Child Support Guidelines*]. In June of 1985, the Judicial Reform Committee of the Indiana Judicial Conference assumed the responsibility for the development of the child support guidelines. This committee was comprised of judges from various counties throughout Indiana. The first draft, completed on July 24, 1987, was presented to the Indiana Judicial Conference Board of Directors on September 15, 1987. The Board of Directors adopted the draft guidelines to be placed in use by October 1, 1987, pursuant to the Child Support Enforcement Amendments of 1984, 42 U.S.C. § 667 (Supp. III 1986). On June 24th, the second edition of the Indiana Guidelines was approved by the Board of Directors of the Indiana Judicial Conference. The final copy was distributed at the Annual Meeting of the Indiana Judicial Conference on September 14, 1988. Copies of the Child Support Guidelines are available from the Indiana Judicial Center, 1800 N. Meridian Street, Suite 404, Indianapolis, Indiana 46202 by mailing an advance payment of \$5.55 to the Indiana Judicial Center and requesting a copy of these guidelines.

4. See, e.g., COLO. REV. STAT. § 14-10-115 (1987); ILL. ANN. STAT. Ch. 40 para. 505 (Smith-Hurd Supp. 1988); MINN. STAT. ANN. § 518.551 (West Supp. 1988).

5. New Jersey adopted guidelines by means of a Supreme Court Rule. See N.J. R. GOVERNING PRACTICE, CHANCERY DIVISION, FAMILY PART R. 5:6A & App. XI (1986). Delaware implemented the Melson Formula by means of a family court rule. See *infra* note 25 and accompanying text.



and administrative regulations.<sup>6</sup>

## II. THE CONCEPT OF GUIDELINES

### A. *The Need for the Guidelines*

Few states used child support guidelines before Congress enacted the Child Support Enforcement Amendments of 1984.<sup>7</sup> The purpose of this congressional mandate was an effort to address deficiencies in the traditional case-by-case method of setting child support orders. Congress perceived that the deficiencies in child support orders generally fell into the following three categories: "(1) a shortfall in the adequacy of the orders, when compared with the true costs of rearing children as measured by economic studies; (2) inconsistent orders causing inequitable treatment of parties in similarly situated cases; and (3) inefficient adjudication of child support amounts in the absence of uniform standards."<sup>8</sup>

A 1985 study by the United States Office of Child Support Enforcement estimated that \$26.6 billion in child support would have been due in the calendar year of 1984 if child support had been set by either the "Delaware Melson Formula" or the "Wisconsin Percentage of Income Standard."<sup>9</sup> A Census Bureau study found that \$10.1 billion in child support was reported due during a similar period of time in 1983 but only \$7.1 billion actually was collected.<sup>10</sup> There was not only a compliance gap of three billion dollars, but also an adequacy gap of over fifteen billion dollars.<sup>11</sup>

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6. Missouri and Utah are among the states which have implemented guidelines by administrative rule. Williams, *Guidelines for Setting Levels of Child Support Orders*, 21 FAM. L.Q. 281, 311 (1987).

7. *Id.* at 282. Marion County, Indiana had child support guidelines in place for approximately seven years prior to the 1984 child support enforcement legislation.

8. *Id.*

9. R. Haskins, *Estimates of National Child Support Collections Potential and the Income Security of Female-Headed Families*, REPORT TO OFFICE OF CHILD SUPPORT ENFORCEMENT, BUSH INSTITUTE FOR CHILD AND FAMILY POLICY, UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL (1985) [hereinafter *Haskins Report*]. See *infra* note 25 and accompanying text (for discussion of the Delaware model); Williams, *supra* note 6, at 290-91 (for discussion of the Wisconsin model).

10. BUREAU OF THE CENSUS, U.S. DEPARTMENT OF COMMERCE, CHILD SUPPORT AND ALIMONY: 1983, CURRENT POPULATION REPORTS, SPECIAL STUDIES, Series P-23, No. 141 (1985) [hereinafter CENSUS BUREAU].

11. *Haskins Report*, *supra* note 9. Estimated child support collections increase approximately at the rate of inflation. The total amount due in 1983 would have been \$25.5 billion under the Delaware or Wisconsin formulas, compared with the Haskins estimate of \$26.6 billion in 1984. The estimated "adequacy gap" of \$15.5 billion is determined by comparing the \$25.5 billion estimate with the Census Bureau figure of \$10 billion.

The mean court-ordered child support obligation in effect in 1983 was approximately \$191 per month for 1.7 children.<sup>12</sup> According to an authoritative study by Thomas Espenshade, an order of \$191 is equivalent to only twenty-five percent of the average expenditures on 1.7 children in middle income households.<sup>13</sup> Assuming that child support should be shared by the parents based upon their ability to generate income, court-ordered support in 1983 should have been 2.5 times higher in order to provide an adequate amount of child support, based upon the income available for the support of those children.<sup>14</sup> Court-ordered child support in 1983 also fell short of minimal standards for the cost of raising children. Based upon the 1983 United States Poverty Guidelines,<sup>15</sup> the average court-ordered child support obligation in 1983 provided only eighty percent of the poverty level.

Two problems contribute to this dramatic gap in adequate child support. The first is inadequate initial orders. A study of initial child support awards conducted by the Denver District Court of Colorado identified various factors which significantly affected the amount of the award, such as the presence of an attorney, the ability of the attorney, whether an award was contested, and the season of the year.<sup>16</sup> Obviously, none of these pertains to the needs of the children or the abilities of the parties to support their children. The second problem is the failure to update child support orders on a regular basis. An order that is more than a few years old is, in all probability, seriously inadequate even if the initial order was reasonable.

Statewide guidelines not only promote the interests of children, but they also may increase the number of voluntary settlements and reduce the time that it takes for a court to adjudicate and resolve cases that are disputed. In addition, guidelines provide a framework within which attorneys can present, and judges can evaluate, the issues in a reasonable fashion.

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12. CENSUS BUREAU, *supra* note 10.

13. T. ESPENSHADE, *INVESTING IN CHILDREN: NEW ESTIMATES OF PARENTAL EXPENDITURES* (1984).

14. CENSUS BUREAU, *supra* note 10. The Census Bureau reported that the mean income of all women due child support in 1983, not including child support actually received, was \$10,226. The income of men owing child support was not known but the mean income of all men was \$18,110. The Espenshade study estimated that \$749 per month was necessary for the support of 1.7 children. T. ESPENSHADE, *supra* note 13. If this is divided in proportion to income, the obligor's share would be \$479 per month or 2.5 times the average court-ordered amount of \$191 in 1983.

15. 48 Fed. Reg. 7010-11 (1983).

16. Yee, *What Really Happens in Child Support Cases: An Imperical Study of Establishment and Enforcement of Child Support Orders in the Denver District Court*, 57 DEN. L.J. 21, 28-37 (1979).



### B. *How to Establish a Guideline*

Child support guidelines must take into account various economic factors which relate to the cost of raising children. A preliminary question concerns minimum child-rearing costs based upon the needs of children at a mere subsistence level. Guideline drafters may use the United States Poverty Guideline for a standard to "specify the minimum income that could support an average family of given composition at the lowest level consistent with the standards of living prevailing in the country."<sup>17</sup> In 1987, this minimum income was \$458 per month for one household member and \$158 for each additional household member.<sup>18</sup> It can be assumed, therefore, that the cost of raising a child at the poverty level is \$158 per month. Most parents represented by a private lawyer have a greater ability to provide for their children than this Poverty Guideline implies.<sup>19</sup>

The second inquiry concerns child-rearing costs above the minimum needed for subsistence. Studies of household expenditure patterns make it clear that when people have higher income, they spend more of it on their children.<sup>20</sup> The Espenshade study uses data from 8,547 households surveyed in the 1972 and 1973 Consumer Expenditure Survey.<sup>21</sup> Espenshade estimated average expenditures on children during that period of time, based upon the socio-economic status of the family and the number of children present, and updated the results to 1986 price levels. For a middle socio-economic status household, the average expenditure on children from birth through age eighteen was \$589 per month for one child, \$914 per month for two children and \$1,145 for three children.<sup>22</sup> Spending on children can be described validly as proportions of household income although the proportions decline as the household income in-

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17. M. Orshansky, *Measuring Poverty*, in THE SOCIAL WELFARE FORUM (1965).

18. *Annual Update of the Poverty Income Guidelines*, 52 Fed. Reg. 5340-41 (1987).

19. Orshansky, *supra* note 17.

20. Williams, *supra* note 6, at 288. The most commonly cited figures on costs of children have been published by the U.S. Department of Agriculture. See C.S. EDWARDS, USDA ESTIMATES OF THE COST OF RAISING A CHILD: A GUIDE TO THEIR USE AND INTERPRETATION, PUB. NO. 1411, U.S. DEPARTMENT OF AGRICULTURE (1981). The best available evidence of child-rearing expenses in the "above poverty level" household is found in the Espenshade study. Espenshade's figures are more appropriate than the U.S.D.A. figures even though the U.S.D.A. figures provide a useful basis for comparison. The U.S.D.A. figures are estimates and are based on data from the 1960/61 Survey of Consumer Expenditures. This is now more than 25 years old. In addition, Espenshade's marginal cost methodology is more valid for determining appropriate levels of child support. See T. ESPENSHADE, *supra* note 13, at 44-59.

21. T. ESPENSHADE, *supra* note 13, at 44-59.

22. T. ESPENSHADE, *supra* note 13, at Table 3. The figures used are for a household with a wife employed part-time on a year round basis.

creases. Thus a household with more income spends proportionately less on its children as its income increases.

A third question relevant to determining levels of child support is to ascertain how spending on the children is affected by the number of children in the family. Expenditures on children as a proportionate share of current family consumption are estimated at 26.2% for one child, 40.7% for two children, 51.0% for three children and 57.5% for four children.<sup>23</sup> When children are added to a household, therefore, spending does not increase in direct proportion to the number of children added. There is a common misconception that these declining increments primarily reflect economies of scale in raising children. To the contrary, these figures seem to indicate a decreasing level of expenditures for each child as family size increases. Equal amounts are not spent on each child, but rather the spending level for each represents only about three-quarters of the amount that would have been spent on one child alone.

### C. *Types of Guidelines*

There are several types of child support guidelines. One is a "flat percentage" guideline, which simply sets child support at a percentage of the obligor's income depending upon the number of children.<sup>24</sup> A second type of guideline follows the Delaware Melson Child Support Formula adopted by the Delaware Family Court for statewide use in January 1979.<sup>25</sup> Under the "Melson formula," the available income of each parent is determined by deducting a self-support reserve from the parent's income. Then, each dependent's primary support need, including child care and extraordinary medical expenses, is computed, and the total primary support amount is prorated between the parents' available net incomes. The Melson formula also allocates a percentage of the remaining available income to pay additional child support. This "standard of living allowance" thus allows children to benefit from their parents' higher living standard. If a parent has dependents other than the child for whom support is being sought, and these other dependents are not covered by a prior court order, the primary support amounts

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23. DEPARTMENT OF LABOR, REVISED EQUIVALENT SCALE FOR ESTIMATING EQUIVALENT INCOMES OR BUDGET COSTS BY FAMILY TYPE, Bulletin No. 1570-2.

24. See, e.g., ILL. ANN. STAT. ch. 40, para. 505 (Smith-Hurd 1987). Minnesota, Illinois, Texas and Wisconsin have adopted guidelines based upon variations of this concept. See Williams, *supra* note 6, at 290-91.

25. Family Courts of the State of Delaware, *The Delaware Child Support Formula: Study and Evaluation*, REPORT TO THE 132ND GENERAL ASSEMBLY (1984). See also DELAWARE CHILD SUPPORT (MELSON) FORMULA, FAMILY COURT OF THE STATE OF DELAWARE (revised 1984) (available from the Office of Child Support Enforcement Reference Center, Room 2525, 330 C Street, S.W. Washington, D.C. 20201); Williams, *supra* note 6, at 295-301.



for<sup>1</sup> them are deducted from the obligor's remaining available income before computing the standard of living allowance. Thus, a noncustodial parent who has two other natural or adopted children living in his or her household is allowed to reduce his or her standard of living allowance by a primary support amount for these two children.

A third type of guideline is the Income Equalization or "Cassetty" model, which attempts to insure that the children of divorced parents suffer the least possible economic hardship and continue to enjoy as nearly as possible the family's pre-divorce standard of living.<sup>26</sup> The Cassetty model exempts from net income the poverty level of support for each member of both households. The total net income of each household is used, not just the income of the parents. Thus, a current spouse of either parent is counted for purposes of applying the poverty level exclusion. The balance of both households' income is allocated between them in proportion to the number of persons in each family unit. There is no separate consideration of child care expenses or medical costs.

A fourth type of guideline is the "income shares" model which was developed by the Institute of Court Management for the National Center for State Courts under the Child Support Guideline Project.<sup>27</sup> The income shares model attempts to provide the child with the same portion of parental income that the child would have received if the parents had continued to live together. This concept was particularly appealing to Indiana's Judicial Reform Committee because it was in compliance with Indiana Code section 31-1-11.5-12.<sup>28</sup> Under Indiana law, consideration must be given not only to the income of the noncustodial parent but to the following four factors:

- (1) the financial resources of the custodial parent;

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26. Cassetty and Douthitt, *The Economics of Setting Adequate and Equitable Child Support Payment Awards*, 12 TEX. ST. B. SEC. REP., FAM., SPECIAL SUPPORT AND VISITATION ISSUE (1984). See also Williams, *supra* note 6, at 302-03.

27. R. Williams, *Development of Guidelines for Child Support Orders*, in REPORT TO THE U.S. OFFICE OF CHILD SUPPORT ENFORCEMENT, NATIONAL CENTER FOR STATE COURTS (1987). This report can be obtained from the Reference Center, U.S. Office of Child Support Enforcement, Switzer Building, Room 2525, 330 C Street, S.W., Washington, D.C. 20201. The report was developed with support from the U.S. Office of Child Support Enforcement under grant number 18-P-20003-3-01. The income shares model is based upon economic evidence of child-rearing expenditures and principles relied upon by the Advisory Panel for the Child Support Guideline Project. This model has been adopted in Colorado, Maine, Michigan, Montana, Nebraska, New Jersey, Vermont and now Indiana. See Williams, *supra* note 6, at 291-95.

28. IND. CODE § 31-1-11.5-12 (1988). See *Child Support Guidelines*, *supra* note 3, at 2-3.

- (2) the standard of living the child would have enjoyed had the marriage not been dissolved or had the separation not been ordered;
- (3) the physical or mental condition of the child and the child's educational needs; and
- (4) the financial resources and needs of the noncustodial parent.<sup>29</sup>

The computation of child support under the income shares model is a three-step process. First, the parents' combined income is determined. Second, this combined income is used to compute a basic child support obligation. This obligation represents the amount which would have been spent on the children if the household had remained intact. Actual work-related child care expenditures and extraordinary medical expenses are added to the basic obligation to arrive at a total child support obligation. Finally, the total obligation is prorated between the parents based upon their proportionate shares of the total income. The noncustodial parent then pays the custodial parent the prorated amount.<sup>30</sup>

This procedure purportedly simulates spending patterns in an intact household where total family income is allocated to the children proportionately. Adjustments can be made under the income shares model for nontraditional custody arrangements such as shared physical custody and split custody. Indiana has not yet adopted or addressed the shared physical and split custody calculations, but income shares models adopted in certain other states include provisions for these calculations. In a shared physical custody arrangement, each parent has physical custody for at least twenty-five to thirty percent of the time.<sup>31</sup> The exact threshold varies from state to state. A total support obligation is calculated separately for each parent. The expenses born directly by each parent under the shared physical custody arrangement are determined, and a theoretical payover amount is calculated for each parent. The net obligor pays the difference between these amounts.<sup>32</sup> A zero child support obligation would result only where both parties earn the same amount of money and share physical custody equally. In split custody situations, each parent has physical custody of at least one child. The calculations are made by computing a theoretical support obligation for the children in the physical custody of each parent. The amounts owed by each parent are

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29. IND. CODE § 31-1-11.5-12(a) (1988). *See also* *Lepper v. Lepper*, 509 N.E.2d 818, 820 (Ind. 1987); *Hunter v. Hunter*, 498 N.E.2d 1278, 1288 (Ind. Ct. App. 1986); *Tucker v. Tucker*, 406 N.E.2d 321, 323 (Ind. Ct. App. 1980). *But see* *In re Marriage of Ferguson*, 519 N.E.2d 735, 739 (Ind. Ct. App. 1988).

30. *Williams*, *supra* note 6, at 293. The figures for the basic obligation are derived from economic data on household expenditures on children.

31. *Id.* at 293-94.

32. *Id.* at 294.



offset, and the parent owing the larger amount is liable for the difference.

#### *D. Use of Child Support Guidelines*

No guideline, regardless of how carefully developed, can anticipate the unique circumstances in every case. Consequently, states generally have implemented their guidelines either as rebuttable presumptions or advisory standards. No state has made a guideline mandatory. Indiana has chosen the advisory approach and, therefore, the new guidelines are merely proposed standards. If Indiana ever does adopt the guidelines as a rebuttable presumption, they would be applied in all support determinations unless one party demonstrates, or the court or administrative agency determines, that an inequity would result. In either case, a departure from the guidelines would have to be accompanied by specific findings which establish the reasons for the deviation.

1. *Applying Guidelines to Modifications.*—As years pass and circumstances change, child support orders which were adequate initially must be updated.<sup>33</sup> Three factors erode the value of child support orders: inflation, income increases and the higher cost of supporting older children. Inflation has caused the real value of an original child support award of \$500 per month in 1976 to decline to \$261 by 1986.<sup>34</sup> In addition, parents with children who are in need of child support are typically at an age when their income increases most rapidly (ages twenty-one to forty-five).<sup>35</sup> Children are entitled to the economic benefits of this increased income. Finally, children's expenses increase as they get older. Espenshade calculated that expenditures are twenty-three percent higher for children in the twelve to seventeen age group than for younger children.<sup>36</sup> In Indiana, the only ground for modifying child support awards is evidence of a substantial and continuing change of circumstances sufficient to warrant a modification.<sup>37</sup> This change must be more than slight. Indiana case law is replete with decisions holding that either the income of the parties or the needs of the children must have changed substantially since the last order was entered.<sup>38</sup>

Procedures for updating child support orders vary from state to state. Minnesota has enacted a process by which each order for child support "shall provide for the biennial adjustment in the amount to be

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33. *Id.* at 314.

34. *Id.*

35. *Id.*

36. T. ESPENSHADE, *supra* note 13, at 30-31.

37. IND. CODE § 31-1-11.5-17 (1988).

38. See, e.g., *Halum v. Halum*, 492 N.E.2d 30 (Ind. Ct. App. 1986); *McCallister v. McCallister*, 488 N.E.2d 1147 (Ind. Ct. App. 1986).

paid based on a change in the cost of living.”<sup>39</sup> The Minnesota statute thus provides for the automatic updating of child support orders. Another proposal would increase child support based either upon the cost of living or inflation rate. These standards are unacceptable in Indiana because they do not reflect the statutory provisions that support be based upon the child’s needs and the parents’ incomes.<sup>40</sup> A better method of updating child support orders would be to apply the same standards that were used for setting the initial support awards. The experience of other states with guidelines would indicate that availability of a guideline tends to encourage the parties to implement their own updating provisions by exchanging tax returns or other information relevant to income and then to apply the new guidelines voluntarily to adjust the amount of child support.<sup>41</sup>

The adoption of Indiana’s new guidelines shifts the focus of child support determinations away from the expenses of the child toward an income-based process. This approach appears to be a fairer way of dealing with child support because it balances the needs of the child against the needs of the parents. Much litigation over child support centers on the necessity of certain expenses claimed by each parent either for their own daily living expenses or the child’s living expenses. The major drawback in basing child support on living expenses is that expenses are always within the control of the parties, can be manipulated easily, and almost always exceed income initially because the parties have not yet adjusted to losing the benefit of combined incomes in an intact household. With child support guidelines, the income of the parties becomes paramount and expenses tend to be ignored except for special considerations. Guidelines should not be adopted, however, without also adopting standards for reporting and verifying income because income also can be manipulated. Ideally, guidelines should require a party to submit income and asset statements and support those statements with

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39. MINN. STAT. § 518.641 (1986).

40. See IND. CODE § 31-1-11.5-12 (1988).

41. Williams & Campbell, *Review of Selected State Practices in Establishing & Updating Child Support Awards*, REPORT TO U.S. OFFICE OF CHILD SUPPORT ENFORCEMENT, NATIONAL INSTITUTE FOR SOCIO-ECONOMICS RESEARCH, 23 (1984). See also Williams & Campbell, *Review of Literature and Statutory Provisions Relating to the Establishment and Updating of Child Support Awards*, in REPORT TO U.S. OFFICE OF CHILD SUPPORT ENFORCEMENT, NATIONAL INSTITUTE FOR SOCIO-ECONOMIC RESEARCH, 1-3 (1984). Williams and Campbell reported that in Delaware many agreements developed by attorneys made a provision for the annual exchange of information and a reapplication of the formula to arrive at a new child support amount. In this same report, it was stated that stipulated agreements in Wisconsin often have similar provisos. The most recent Colorado statutory provisions for determining child support also encouraged the use of guidelines in a voluntary updating process. See COLO. REV. STAT. § 14-10-115 (1986).



documentation such as pay records for the previous twelve to eighteen months.

2. *Allocating Ordinary and Extraordinary Child Care, Medical and Educational Expenses.*—Although there has been no reported litigation in Indiana addressing the difference between extraordinary and ordinary expenses, courts in other jurisdictions have considered various criteria to distinguish between extraordinary and ordinary expenses. One commentator suggests that a portion of any child-related expense, including medical and educational expenses, can properly be considered ordinary if the amounts involved are relatively small, predictable and fairly consistent in families of the same size and income level.<sup>42</sup>

Ordinary child care expenses include babysitting in order to permit a parent to shop, see a physician, attend social obligations, and engage in similar activities.<sup>43</sup> Minor ordinary medical expenses would be those included in deductibles for insurance purposes.<sup>44</sup> Ordinary educational expenses might include the cost of school supplies and field trips.<sup>45</sup>

In comparison, extraordinary child care expenses include those expenses necessary for full-time or substantial part-time child care in order to allow a parent to work.<sup>46</sup> Extraordinary major medical bills may be any medical expense that is necessary, out-of-pocket, and not usual or ordinary.<sup>47</sup> Extraordinary educational expenses include the costs of college, graduate school or a private elementary or secondary school education.<sup>48</sup> An "extraordinary" expense, therefore, could be defined as "any large, discrete, legitimate child-rearing expense that varies greatly from family to family or from child to child."<sup>49</sup>

Extraordinary expenses have received varying treatment in determining child support obligations. One approach is simply to include the extraordinary expense as basic child support,<sup>50</sup> while another method makes no specific provision for extraordinary expenses at all.<sup>51</sup> Other methods include deducting extraordinary expenses from the income of the parent paying such expenses before calculating the child support

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42. Goldfarb, *Child Support Guidelines: A Model for Fair Allocation of Child Care, Medical and Educational Expenses*, 21 FAM. L.Q. 325, 330 (1987).

43. *Id.* at 337-38.

44. *Id.* at 342.

45. *Id.* at 343.

46. *Id.* at 338.

47. *Id.* at 342-43.

48. *Id.* at 343-44.

49. *Id.* at 331.

50. See WOLFE, CHILD SUPPORT GUIDELINES PROJECT: STATE BY STATE SUMMARY, NOW Legal Defense and Education Fund (1986).

51. *Id.*

award,<sup>52</sup> and granting a bonus not directly tied to the amount of the expense to the parent who is paying the extraordinary expense.<sup>53</sup> Some states do not apply the guidelines to cases which involve extraordinary expenses and decide those matters on a case-by-case basis.<sup>54</sup> Finally, extraordinary expenses may be prorated in proportion to the parents' incomes and the prorated amount added to the basic child support award.<sup>55</sup>

The new Indiana guidelines follow this last approach and prorate extraordinary expenses according to the parents' relative incomes.<sup>56</sup> The primary advantage of this technique is that it realistically addresses the actual cost incurred by the custodial parent. A disadvantage is that, even though these child care, medical and education expenses may vary greatly from year to year, the amount added by court order to the non-custodial parent's support obligation would not change from one year to the next to accommodate the variations. Furthermore, in the event that courts use "reasonable" or "reasonable and necessary" language to define extraordinary expenses, the door would be open to second-guessing by the parties and to litigation regarding what is reasonable and necessary. Nonetheless, the interests of all the parties are served by an approach which takes into account the financial situation of each parent in addition to the nature of each expense.

Any provision addressing extraordinary medical expenses must encompass all types of medical, dental and related professional care. Obviously, the level of expense that rises to a catastrophic level may not be easily addressed by any guideline. The custodial, the noncustodial parent, or both may deduct a medical expense on their tax returns if they actually incurred the expense.<sup>57</sup> For tax purposes, therefore, the parent with the lower adjusted gross income, who can maximize the medical deduction, should be the party who writes the checks for as many of the medical bills as possible.

Educational expenses such as school supplies and field trips usually do not rise to the level of an extraordinary expense. Extraordinary educational expenses generally relate to the cost of college, graduate or professional school, private school, extra lessons, enrichment, or special educational needs for a disabled child. Traditionally, divorced fathers, including those with high incomes and high educational attainments of their own, do not contribute voluntarily to their children's college ed-

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52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *Child Support Guidelines*, *supra* note 3, at 17-18.

57. See I.R.C. § 213(d)(5) (1986).



ucation.<sup>58</sup> Some divorced fathers may be even less inclined to assist their daughters with higher education needs than their sons.<sup>59</sup> Unfortunately, providers of financial aid consider all of the income supposedly available to the child. Consequently, the noncustodial parent's financial resources may result in the child being refused financial aid. This is the basis of Symer and Cooney's theory that children of divorce are more likely to defer college attendance until they can accumulate savings through their own earnings.<sup>60</sup>

Indiana law comprehensively sets forth the rights and obligations of children who wish to attend college. Courts may consider several factors in deciding whether parents should provide a college education for their children. These factors include the parents' educational levels, the child's career goals, the resources and abilities of the parents and the child to pay for the education, the child's educational accomplishments, the emphasis that has been placed on education in the home, and the educational traditions of the family measured by the educational achievements of other children in the family.<sup>61</sup>

Extraordinary educational needs other than college may include private school, lessons, enrichment, and educational needs of disabled children. Inclusion of expenses for private schooling should be supported by evidence that such schooling is affordable to the family and that the parents likely would have incurred that expense had they remained married. Lessons in enrichment should be treated as ordinary expenses unless they are extremely costly or unusual. Expenses for items such as music lessons, camps, sports equipment, and religious instruction should be deemed ordinary because they commonly are provided by parents and are of a modest cost. The educational needs of a disabled child, to the extent that the parties can meet them, should be allocated between the parties based upon their incomes.

### III. THE INDIANA CHILD SUPPORT GUIDELINES

#### A. *Commentary of the Judicial Reform Committee*

Previous sections of this Article have outlined many factors which must be considered when child support guidelines are established. The

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58. Wallerstein & Corbin, *Father-Child Relationships After Divorce: Child Support and Educational Opportunity*, 20 FAM. L.Q. 109, 119 (1986).

59. *Id.* at 121.

60. Symer & Cooney, *Family Relations Across Adulthood: Implications for Alimony and Support Divisions* 10-11, American Bar Association National Symposium on Alimony and Child Support (Apr. 24-25, 1987).

61. IND. CODE § 31-1-11.5-12 (1988). *See also* Thiele v. Thiele, 479 N.E.2d 1324 (Ind. Ct. App. 1985); Gower v. Gower, 427 N.E.2d 703 (Ind. Ct. App. 1981).

Judicial Reform Committee of the Judicial Conference of Indiana was assigned the task of developing the guidelines for the State of Indiana. After this process was completed and a framework for the guidelines was established, the task of these judges was to explain the meaning of the terms used. Anytime a guideline is established, it is beneficial for all the parties who will be using that guideline to understand with reasonable certainty the terminology and parameters covered. If this basis is clearly established, then application of the guidelines becomes a simple matter.

Every family is different and the needs of every child are different. Therefore, the application of guidelines without considering all of the issues is inappropriate. To assist all persons in understanding and interpreting Indiana's Guidelines, the Judicial Reform Committee developed a Commentary that is incorporated into the Guidelines. With the permission of the Judicial Reform Committee, the authors have reprinted for your benefit much of the Commentary from the Guidelines.<sup>62</sup> The following excerpts were written by Judge Bruce Embry, a member of the Judicial Reform Committee:

### 1. *Lower Limits of the Guidelines*

The Guidelines schedules for weekly support payments do not provide an amount of support for couples with combined weekly available income of less than \$100.00. Consequently, the Guidelines do not establish a minimum support obligation. Instead, the facts of each individual case must be examined and support set in such a manner that the obligor is not denied a means of self-support at a subsistence level. It is, however, recommended that a specific amount of support be set. Even in situations where the non-custodial parent has no income, courts have routinely established a child support obligation at some minimum level. While an obligor cannot be held in contempt for failure to pay support when he does not have the means to pay, the obligation accrues and serves as a reimbursement to the custodial parent or, more likely, to the welfare department when he later acquires the ability to meet his obligation.<sup>63</sup>

### 2. *Upper Limits of the Guidelines*

The Guidelines schedules for weekly support payments provide calculations for the basic support obligation to a combined weekly

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62. Because the Commentary to the Guidelines are not generally available in any widely circulated, published form the remainder of this Article is devoted to reprinting much of the Commentary—Ed.

63. *Child Support Guidelines*, *supra* note 3, at 7.



available income of \$2,000.00, or annual available income of \$104,000.00. It is indeed a rare case where a higher figure will be needed. It is not intended, however, that the obligation for support be capped at that level. It is instead anticipated that parties with income in excess of that amount would negotiate a support figure, or that the court, in the alternative, would use the mathematical progressions of the Guideline to arrive at a support obligation.<sup>64</sup>

### 3. *Temporary Maintenance*

It is . . . recommended that temporary maintenance awards not exceed 35% (thirty-five percent) of the obligor's weekly available income. The maximum award should be reserved for those instances where the custodial spouse has no income or no means of support, taking into consideration that spouse's present living arrangement (i.e., whether or not they are living with someone who shares or bears the majority of the living expense; whether they are living in the marital residence with little or no expense; whether they live in military housing, etc.).

It is further recommended that the total of temporary maintenance and child support should not exceed 60% (sixty percent) of the obligor's weekly available income. In computing temporary maintenance, in-kind payments, such as the payment of utilities, house payments, rent, etc., should also be included in calculating the percentage limitations.

It should also be emphasized that the recommendations concerning maintenance apply only to *temporary maintenance*, not spousal maintenance in the final decree. An award of spousal maintenance in the final decree must, of course, be made in accordance with I.C. 31-1-11.5-11(e). These Guidelines do not alter those requirements. Theoretically, when setting temporary maintenance, child support should come first. That is, if child support is set at 40% of the obligor's weekly available income, only a maximum of 20% (twenty percent) of that income would be available for maintenance. That distinction, however, makes little practical difference.

The worksheet provides a deduction for spousal maintenance paid as a result of the former marriage (line 1D.) Caution should be taken to assure that any credit taken is for maintenance and not for periodic payments as the result of a property settlement pursuant to I.C. 31-1-11.5-11(b)(2). No such deduction is given

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64. *Id.*

for amounts paid by an obligor as the result of a property settlement resulting from a former marriage, although that is a factor the court may wish to consider in determining the obligor's ability to pay the scheduled amount of support at the present time. Again, flexibility was intended throughout the Guidelines and they were not intended to place the obligor in a position where he or she loses all incentive to comply with the orders of the court. If an obligor is burdened by support, maintenance and periodic payments from a former marriage, it is possible to surpass the point where the obligor cannot subsist. Studies indicate that when the combined payments exceed 60% (sixty percent) of income, a level of resistance is reached where an obligor is likely to simply give up.<sup>65</sup>

#### 4. *When Guidelines are Applicable*

It is recommended that the Indiana Child Support Guidelines be applied in every instance in which child support is established, including, but not limited to, dissolutions of marriage and paternity actions.<sup>66</sup>

#### *B. Determination of Child Support Obligations*

Weekly gross income, potential income, weekly available income and basic child support obligation are terms that presently are foreign to Indiana lawyers, but they soon will resound throughout the courtrooms of the state. An understanding of these new terms is necessary before child support obligations can be calculated under the new guidelines.

1. *Weekly Gross Income.*—Weekly gross income<sup>67</sup> is the starting point in determining the child support obligation. It must be calculated

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65. *Id.* at 8. For the worksheet referred to above, see "Worksheet—Child Support Obligation" *infra* p. 227, reproduced as an appendix to this Article with the permission of the Indiana Judicial Conference [hereinafter *Worksheet*].

66. Child Support Guidelines, *supra* note 3, at 9.

67. See *Worksheet*, *supra* note 65, at line 1. "Weekly Gross Income" is "actual weekly gross income of the parent if employed to full capacity, potential income if unemployed or underemployed, and imputed income based on 'in-kind' benefits." *Child Support Guidelines*, *supra* note 3, at 9. This includes income from any source except for specific exclusions and includes but is not limited to "income from salaries, wages, commissions, bonuses, dividends, severance pay pensions, interest, trust income, annuities, capital gains, social security benefits, workmen's compensation benefits, unemployment insurance benefits, disability insurance benefits, gifts, prizes, and alimony or maintenance received from other marriages." *Id.* Means-tested public assistance programs are specifically excluded.

Weekly Gross Income from self-employment, operation of a business, rent, and



for both parents. If one or both parents have no income, potential income should be calculated and used as weekly gross income. Likewise, imputed income may be substituted for, or added to, other income in arriving at weekly gross income. Imputed income includes such items as free housing, a company car that may be used for personal travel, reimbursed meals, and other items received by the obligor that reduce his or her living expenses.

The Commentary suggests beginning with total income from all sources.<sup>68</sup> Actual business expenses are deducted from that total figure but not losses which do not result in actual out-of-pocket expenditures. It was not the drafters' intent to recognize tax shelters otherwise permitted by federal tax laws. In addition, public assistance programs based on income<sup>69</sup> are excluded from the computation of weekly gross income, but other government payments such as Social Security benefits and veterans pensions are included.

Calculating weekly gross income for the self-employed or for those who receive rent or royalty income presents unique problems and requires a careful review of expenses. Actual expenses are excluded, but benefits that reduce living expenses, such as company cars, free lodging and reimbursed meals are included in whole or in part. Although income tax returns may be helpful in arriving at weekly gross income for a self-employed person, the deductions allowed by the guidelines differ significantly from those allowed for tax purposes.

Potential income must be determined if a parent has no income, or only means-tested income, and is capable of earning income or capable

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royalties is defined as gross receipts minus ordinary and necessary expenses. Specifically excluded from ordinary and necessary expenses for the purposes of these Guidelines are depreciation, investment tax credits, or any other business expense determined by the Court to be inappropriate for determining weekly gross income for the purposes of calculating child support. . . . Expense reimbursement or in-kind payments received by a parent in the course of an employment, self-employment, or operation of a business should be counted as income.

*Id.* Potential income is calculated for parents who are voluntarily unemployed or under-employed. It is determined by establishing the

employment potential, and probable earnings level based on the obligor's work history, occupational qualifications, prevailing job opportunities, and earning levels in the community. If there is no work history and no higher education or vocational training, it is suggested that weekly gross income be at least at the minimum wage.

*Id.* at 10.

68. This figure may not be the same as gross income for tax purposes. See I.R.C. § 61 (1986); *Child Support Guidelines*, *supra* note 3, at 10.

69. Such means-tested programs include Aid to Families with Dependent Children, Supplemental Security Income, Food Stamps, and General Assistance. *Child Support Guidelines*, *supra* note 3, at 9.

of earning more than he or she presently earns. Obviously, this determination requires a great deal of discretion. One purpose of the potential-income factor is to discourage a parent from taking a lower paying job to avoid the payment of significant support. Another purpose is to allocate the support obligation fairly when one parent remarries and, because of the income of the new spouse, chooses not to be employed. Attributing potential income to a parent undoubtedly will cause much stimulating debate.<sup>70</sup>

One situation that must be considered is that of the mother with one or more young children at home. It was not the intention of the Judicial Reform Committee to force all custodial parents into the work force. Therefore, discretion must be exercised on an individual case basis to determine if it is fair under the circumstances to impute income to a particular nonworking or under-employed custodial parent. Consideration should be given to the needs of the child or children as well as the earning potential of the parent. A custodial parent without a high school education, with no significant skills and with three small children may not be capable of entering the work force and earning enough even to cover the cost of day care. This will be a fact-sensitive issue which must be decided on a case-by-case basis.

2. *Income Verification*.—The income verification requirement is not a change in the law but merely a suggestion to judges that they take care in determining the income of each parent. Some forms of documentation, such as a single pay stub, can be very misleading. This is particularly true for salesmen, professionals, and others who receive commissions or bonuses, or who have the ability to distort the true picture of their income in the short-term by deferring payments. When in doubt, income tax returns for the last several years should be reviewed.<sup>71</sup>

3. *Computation of Weekly Available Income*.—After weekly gross income is determined, weekly available income must be computed.<sup>72</sup> Certain deductions from weekly gross income are allowed in arriving at weekly available income. For example, an obligor is entitled to deduct child support for children of other marriages if he or she actually is paying that support. For purposes of this deduction, the Judicial Reform Committee recommends a first in time, first in right rule which considers the children in the order in which they were born. Thus the computation of support based on the income that would have been available to the second family, had it remained intact, allows for a deduction for support

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70. *Id.* at 11.

71. *Id.* at 12.

72. *Id.* at 13. See also *Worksheet*, *supra* note 65, at line 2.



of children from previous relationships. This rationale is in compliance with Indiana Code section 31-1-11.5-12(a)(2),<sup>73</sup> and therefore prevails over the argument that the second family has just as much right to the income of the obligor as the first family.

When considering a petition to modify support arising out of a first marriage, however, no deduction is allowed for support ordered as the result of a second or subsequent marriage. A support order for a subsequent family does not constitute a change in circumstances with respect to the support of children of the first marriage.<sup>74</sup> Likewise, if support is being established or modified for a child born out of wedlock, the date of birth of the child would determine whether or not a deduction is allowed in arriving at weekly available income. If the child was born before the marriage, no deduction for children of the marriage would be allowed. If the child was born after a marriage from which an obligation for support arose, a deduction would be allowed.<sup>75</sup>

Although deductions are allowed only for support actually being paid, some discretion is necessary. If there is a valid court order or obligation for support which the obligor has not been paying, but for which enforcement proceedings are imminent, a denial of the deduction likely would lead to further court proceedings in the form of a petition to modify.<sup>76</sup>

Deductions also are allowed for funds actually expended on behalf of children toward whom the obligor has a legal duty of support, even if that obligation has not been reduced to a court order. Children born out of wedlock are the obvious example, but this provision covers other situations as well. A custodial parent who is not receiving support should be permitted to deduct his or her portion of the support obligation for the children in the home from the first marriage. For example, in computing support for the second dissolution, the custodial parent of two children from a prior marriage who receives no support from that former spouse, should be permitted to deduct the support he or she would be paying if custody of these children had been placed with the noncustodial spouse. The second dissolution therefore will require a computation of the support obligation allocated to each spouse for children of the prior marriage.<sup>77</sup>

The cost of health insurance for the children also is deducted from weekly gross income in arriving at weekly available income. Computing the allowable deduction is no problem if a separate policy of insurance

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73. IND. CODE § 31-1-11.5-12(a)(2) (1988). See *supra* text accompanying note 29.

74. *Child Support Guidelines*, *supra* note 3, at 13.

75. *Id.*

76. *Id.*

77. *Id.* at 14.

is purchased for the children. In most situations, however, employer group plans provide coverage for the children. No deduction is allowed if the employer pays the entire cost of coverage. If the employee pays part of the premium, it may be necessary to obtain from his or her employer appropriate documentation of the additional cost for the children's coverage in order to compute the deduction for purposes of determining the child support obligation.<sup>78</sup>

Another allowable deduction from weekly gross income is alimony or spousal maintenance arising from a prior marriage. These amounts are allowable only if they arise as the result of a court order and actually are being paid, or if enforcement of the obligation appears imminent. This deduction is intended *only* for spousal maintenance, not for periodic payments pursuant to a property settlement under Indiana Code section 31-1-11.5-12(b)(2).<sup>79</sup> The result after subtracting allowable deductions will be a figure representing the weekly available income of each parent.

4. *Basic Child Support Obligation.*—The next step is to determine the recommended basic support obligation for the combined incomes of both parents on the chart in the Guideline schedules for weekly support payments.<sup>80</sup> It should be remembered that the number of children in the chart refers only to the number of children of the marriage being dissolved for whom support is being computed. Furthermore, the Guidelines do not contain figures for combined weekly available income of less than \$100 or more than \$2,000.<sup>81</sup>

5. *Adjustments to the Basic Child Support Obligation.*—Certain adjustments are applied to the basic child support obligation in arriving at the total child support obligation. The following items have been and will continue to be the basis of heated battles between parents. Consequently, the court or the parties may deal with these matters as separate and distinct issues apart from child support in appropriate situations.

Reasonable child care costs that are incurred by either parent due to employment, or an attempt to find employment, typically are added to the basic child support obligation in arriving at the total child support obligation. Both parents should bear the responsibility for such costs. If this expense is not included in computing the child support obligation, the custodial parent may find that it is not economically feasible to be employed because, after the payment of child care and transportation expenses, the household income is little more than if that parent had remained unemployed.<sup>82</sup>

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78. *Id.*

79. IND. CODE § 31-1-11.5-12(b)(2) (1988). See *Child Support Guidelines*, *supra* note 3, at 14.

80. *Child Support Guidelines*, *supra* note 3, at 15.

81. *Id.* See *supra* notes 63-64 and accompanying text.

82. *Child Support Guidelines*, *supra* note 3, at 17.



Extraordinary uninsured health care expenses for a child's chronic or long-term condition also may be added to the basic child support obligation. Orthodontia, dental treatment, asthma treatment, physical therapy, counseling, and psychiatric therapy are illustrative but not an exhaustive list of maladies for which adjustments may be made. The emphasis is on *long-term* to avoid frequent modifications of the support order.<sup>83</sup> For example, if the cost of extensive orthodontia will be spread over a three-year period, there is a reasonable basis for including it in the computation of support. If the condition for which an additional contribution of support is sought will be shorter in duration, such as six months of physical therapy following an accident, the better practice may be to consider the cost in a separate order which apportions the obligation between the parents.

Many courts routinely apportion between the parties, usually on an equal basis, the medical, dental and optical expenses that exceed insurance. The Guideline Schedules were based on data which included a component for ordinary medical expenses; six percent of the recommended support amount is for health care expense.<sup>84</sup> If an apportionment is made for extraordinary health care expenses, therefore, the custodial parent should absorb a certain portion of the cost for each illness or injury before the noncustodial parent is required to contribute. The balance of these health care expenses then could be apportioned according to the income share percentages set forth in the tables in the Guidelines.

Extraordinary educational expenses for elementary, secondary or higher education also may be added to the basic child support obligation, but they should be limited to expenses which are reasonable and necessary for attending private or special schools or institutions of higher learning, or necessary to meet the particular educational needs of the child. Regardless of the level of schooling involved, questions of educational expense are likely to be fact-sensitive and cannot be reduced to a specific formula.<sup>85</sup> If the expenses sought to be included are for elementary or secondary education, the court may consider whether the expense is the result of a personal preference of one parent or both parents concur, whether the expense was incurred while the family was intact, and whether education of the same or higher quality is available at less cost. If the additional expense is for higher education, the court should consider the availability of scholarships, grants, student loans, summer and school-year employment, and other cost-reducing programs available to the student. The student is expected to apply for available aid, and a failure

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83. *Id.*

84. *Id.* at 18.

85. *Id.*

to do so should be a factor in establishing the parents' obligation for educational expenses.<sup>86</sup>

These expenses may be covered in a separate order, as for short-term health care expenses, or included in the child support order. If they are part of the child support order, it should be remembered that there is already an allowance for some living expense. The basic child support obligation, however, does not allow for all the expenses of separate housing while a student is attending college. If support for higher education is established in a separate order, support paid to the custodial parent should be reduced for the period of time that the student is away from the household and at school.<sup>87</sup>

The addition of work-related child care costs, extraordinary health care expenses and extraordinary educational expenses to the basic child support obligation produces the total child support obligation of both parents. This total obligation approximates the cost of supporting the same children if the marriage had remained intact.

6. *Computation of Child Support.*—After the total child support obligation is determined, it is apportioned between the parents. First, the weekly available income of each parent is divided by the total available income to determine each parent's share of weekly income. The child support obligation of each parent is the same percentage share of the total child support obligation. The noncustodial parent is ordered to pay his or her proportionate share of support to the custodial parent. Support orders are not entered against custodial parents because they are presumed to meet their obligations by direct expenditures on behalf of their children.<sup>88</sup>

### C. Modification

To modify a child support order, Indiana requires a showing of a substantial and continuing change in circumstances that makes the present order unreasonable.<sup>89</sup> The Guidelines suggest that if the new total support obligation is significantly higher than the present obligation, a new order may be warranted. The increase may result from a change in the income of either parent or from changes in the child-rearing expenses which are covered specifically in the Guidelines. If the new support obligation is significantly higher than the prior obligation and requires a drastic reduction in the obligor's standard of living, the additional support

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86. *Id.*

87. *Id.*

88. *Id.* at 19.

89. IND. CODE § 31-1-11.5-17 (1988).



required under the Guidelines should be phased in.<sup>90</sup> This approach would allow the obligor time to make adjustments in his or her standard of living. It was not the drafters' intent to drive obligors into noncompliance by reducing their spendable income below subsistence level.

#### D. *Additional Considerations*

1. *Shared or Joint Custody*.—The Indiana Guidelines do not confront the problem of establishing a support order in situations of shared or joint custody. This type of determination is left to the sound discretion of the trial court on a case-by-case basis because of the infinite variations in the amount of time a child may spend in the custody of each parent and other considerations such as the cost of travel between parents.<sup>91</sup>

2. *Split Custody*.—In those situations where each parent has physical custody of one or more children, support could be computed under the Guidelines in the following manner. First, the support which the husband would pay the wife for the children in her custody should be computed as if they were the only children of the marriage. The support which the wife would pay to the husband for the children in his custody then should be computed as if they were the only children of the marriage. The lesser amount should be subtracted from the greater amount, and the spouse who owes the greater amount of support will pay the difference. This method of computation takes into account the fact that the first child in each home is always the most expensive to support.<sup>92</sup>

3. *Abatement of Support During Extended Visitation*.—Many of the same problems encountered in establishing support in shared and joint custody arrangements exist in determining whether, or how much, to abate support during periods of extended visitation. Factors which should be considered include travel costs, length of stay, savings to the custodial parent, the respective incomes of the parents, and ongoing expenses of the custodial parent while the children are with the noncustodial parent.<sup>93</sup> If the support obligation of the noncustodial parent is minimal, the custodial parent may not be able to meet the ongoing expenses arising from custody of the children if support is abated completely during extended visits. Total abatement of support rarely would be equitable to the custodial parent. Nonetheless, if a complete abatement of support is ordered during visitation, the court should consider increasing the support obligation slightly above the recommended amount during the remainder of the year so that the average support over the entire year

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90. *Child Support Guidelines*, *supra* note 3, at 20.

91. *Id.* at 21. See also IND. CODE § 31-1-11.5-21(f) and (g) (1988).

92. *Child Support Guidelines*, *supra* note 3, at 21.

93. *Id.*

allows the custodial parent to meet the fixed expenses of the children.<sup>94</sup>

4. *Blended-Rate Schedules for Weekly Support Payments.*—The rates of support shown in the Guideline schedules for weekly support payments do not relate directly to the age of the child. Other jurisdictions have adopted schedules based either on the ages of all the children in the family, or on the age of the oldest child.<sup>95</sup> Typically, the age groupings are birth to six years of age, six to twelve years, and twelve years and over. Indiana's Judicial Reform Committee reviewed extensive economic data and concluded that the most significant change in the cost of child-rearing comes when a child enters school. The Committee therefore adopted a schedule that was not based on age, but which allows for the increased ordinary expenses of school-age children.<sup>96</sup> A blended rate was devised which averages the different ordinary expenditures incurred from birth to the age of eighteen. This blended rate may result in a slight bonus to custodial parents with children under the age of six, but this advantage was deemed preferable to the complex problems in applying age-based rates.<sup>97</sup> It can be said, therefore, that children's ages are taken into consideration in the Guidelines, even though the support computation does not specifically account for age.

5. *Tax Consequences.*—It is not necessary to compute or to be concerned with tax consequences when using the Guidelines because these considerations were factored into the rates in the Guideline schedule for weekly support payments. Future changes in the tax laws should be monitored for impact on the Guidelines, and rates will have to be adjusted accordingly.

6. *Gradual Implementation.*—Some courts may prefer to implement orders made under the new Guidelines gradually, especially when the support computed under the Guidelines is considerably higher than the amount that was being paid, or was anticipated, under the former system for establishing support in a particular jurisdiction.

#### IV. CONCLUSION

The adoption of the Child Support Guidelines could be one of the most significant developments in Indiana law for women and children. Basing support on the actual cost of raising children will improve the economic status of children of a dissolved marriage. The recognition by lawyers and judges that families with greater incomes spend more on their children also will enhance the standard of living for all socio-

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94. *Id.*

95. *Id.* at 22.

96. *Id.*

97. *Id.*



economic groups involved in the dissolution of marriage and the establishment of child support.

The "income shares model" approach adopted by Indiana provides a fair and reasonable approach to providing support for children by both parents. In the past, Indiana law has provided a subjective "need-based" test for establishing child support. The removal of this subjective test enhances fairness and equitable treatment of litigants in determining child support obligations.

Courts previously have not had a system or method for dealing with extraordinary medical and educational expenses. The new Guidelines spread these unusual costs between the parents, based upon the parties' abilities to pay. The guideline method of establishing child support is a more predictable means of determining the funds available for the support of children, the types of income, and the extraordinary needs of children, so that even though the mother and father may be divorcing, the children of our society will not suffer.

APPENDIX

IN RE:			
FATHER			
MOTHER			
WORKSHEET — CHILD SUPPORT OBLIGATION			
Children	DOB	Children	DOB
1. WEEKLY GROSS INCOME		FATHER	MOTHER
A. Minus Child Support — Court Order			
B. Minus Child Support — Legal Duty			
C. Minus Health Ins. Prem. for Child Only			
D. Minus Maintenance Paid			
2. WEEKLY AVAILABLE INCOME			
3. PERCENTAGE SHARE OF INCOME (Line 2, Each Parent's Weekly Available Income divided by Combined Weekly Available Income)		%	%
4. BASIC CHILD SUPPORT OBLIGATION (Apply Line 2 to Child Support Schedule)			
A. Plus Work-Related Child Care Costs			+
B. Plus Extraordinary Healthcare Expenses (Uninsured only)			+
C. Plus Extraordinary Education Expense (Agreed or ordered by Court)			+
5. TOTAL CHILD SUPPORT OBLIGATION (Add Line 4, plus 4 A, B, and C)			
6. EACH PARENT'S CHILD SUPPORT OBLIGATION (Multiply Line 3 times Line 5 for each parent) (State exceptions and attach supporting documents to reverse of page)			
7. ENTER RECOMMENDED CHILD SUPPORT ORDER			
Comments, calculations, or rebuttals to schedule:			
PREPARED BY:		DATE:	





# Insurance Law

JOHN C. TRIMBLE\*

## I. INTRODUCTION

In general, the year in insurance law was interesting even though there were a minimal number of published decisions. This Article examines several of those cases and attempts to keep the practitioner abreast of current trends in Indiana insurance case law as well as changes in Indiana statutes governing different aspects of insurance law.

One of the more notable decisions during the survey period reversed the long-standing principle in Indiana that an insurance broker was the agent of the proposed insured for insurance procurement purposes. This has been an area of constant litigation, and the decision in *Aetna Insurance Co. v. Rodriguez*<sup>1</sup> will be of interest to the insurance practitioner.

Other cases reported on in this Article examine such issues as the court's construction of the phrase "alighting from an automobile" for the purpose of uninsured motorist coverage, an insurer's burden of proof when relying on a "cooperation clause" as a defense, insurance coverage for second permittees, and intoxication as a defense to denying coverage when a policy excludes coverage for intentional acts. This Article also reviews some of the additions and amendments enacted by the 1987 General Assembly.

## II. RELATIONSHIP BETWEEN BROKER AND COMPANY

During the survey period,<sup>2</sup> the Indiana Supreme Court decided a case that will have far-reaching consequences on the issue of insurance company liability for the acts or omissions of insurance brokers. In the case of *Aetna Insurance Co. v. Rodriguez*,<sup>3</sup> the court made the blanket statement that "in Indiana when a broker makes application for insurance and the insurance policy is issued, the broker is the agent of the insurer and can bind it within the scope of his authority."<sup>4</sup> The court's statement

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\* Member of the firm of Robert F. Wagner, P.C., and associated with the offices of Lewis, Bowman, St. Clair & Wagner. B.A., Hanover College, 1977; J.D., Indiana University School of Law—Indianapolis, 1981. The author wishes to acknowledge his appreciation for the assistance provided by law student Susan Mehringer.

1. 517 N.E.2d 386 (Ind. 1988).

2. August 1, 1987, to July 1, 1988.

3. 517 N.E.2d 386 (Ind. 1988).

4. *Id.* at 388.



on this issue represents a reversal of the previously accepted rule that an insurance broker is the agent of the proposed insured for all purposes relating to the procurement of insurance.<sup>5</sup>

The case arose from a transaction in 1979 in which Mr. Rodriguez purchased a building from Shaver Motors, Inc. (Shaver). As a part of the transaction, Shaver obtained and recorded a mortgage on the property, and Rodriguez agreed to insure the premises for Shaver's benefit. Rodriguez contacted an insurance broker named Nick George to obtain the insurance. Ultimately, Aetna Insurance Company of the Midwest issued a policy to Rodriguez. The policy had a standard mortgage clause which protected any mortgagee named on the declarations page. However, Shaver was not named in the declarations. Instead, Shaver was erroneously listed on an endorsement as a contract seller.<sup>6</sup>

At a later date, the building burned. When Shaver made a claim under the standard mortgage clause, Aetna would not pay, and litigation ensued.<sup>7</sup>

Each party filed for summary judgment. In a lengthy written opinion, the trial court granted summary judgment in favor of Shaver for several reasons. First, the court excused Mr. Rodriguez for not knowing the specific manner in which Shaver should have been listed on the policy. In the same vein, the court held that the broker-agent and the company should bear the burden of asking the proposed insured enough facts to determine how the additional insured should be shown on the policy. Additionally, under the specific facts of the case, the court found that Nick George acted as an agent for the company and not as agent for the proposed insured. Therefore, Aetna Insurance was held liable for George's failure to list Shaver properly on the policy, and Aetna was estopped from denying coverage to Shaver.<sup>8</sup>

On appeal, one of Aetna's principle arguments was that an insurance broker in Indiana is always considered to be the insured's agent for purposes of procuring insurance.<sup>9</sup> Relying upon the cases of *Stockberger v. Meridian Mutual Insurance Co.*<sup>10</sup> and *Automobile Underwriters, Inc.*

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5. *Monarch Ins. Co. v. Siegel*, 625 F. Supp. 693 (N.D. Ind. 1986); *Steward v. City of Mt. Vernon*, 497 N.E.2d 939 (Ind. Ct. App. 1986); *Stockberger v. Meridian Mut. Ins. Co.*, 182 Ind. App. 566, 395 N.E.2d 1272 (1979); *Bulla v. Donahue*, 174 Ind. App. 123, 366 N.E.2d 233 (1977); *Automobile Underwriters, Inc. v. Hitch*, 169 Ind. App. 453, 349 N.E.2d 271 (1976).

6. *Aetna Ins. Co. v. Rodriguez*, 496 N.E.2d 1321, 1322 (Ind. Ct. App. 1986), *vacated*, 504 N.E.2d 1030 (Ind. Ct. App. 1987), *rev'd*, 517 N.E.2d 386 (Ind. 1988).

7. *Id.*

8. *Id.* at 1322-24.

9. *Id.* at 1324.

10. 182 Ind. App. 566, 395 N.E.2d 1272 (1979).

*v. Hitch*,<sup>11</sup> Aetna argued that any mistakes of Nick George should be imputed to Rodriguez rather than to Aetna.<sup>12</sup>

The Indiana Court of Appeals disagreed, noting that at the time of the *Stockberger* and *Hitch* decisions there was an Indiana insurance statute which stated: "[A]n insurance broker is hereby declared to be the agent of the insured for all purposes in connection with such insurance."<sup>13</sup> However, in 1977, the Indiana General Assembly repealed the earlier statute and replaced it with a new one.<sup>14</sup> The new version of the statute did not contain the same agency language as the previous statute.

Because the 1977 legislation did not contain the provision concerning brokers' authority, the court noted that it appeared that "the Indiana common law has been restored to the state it was in before the [1971] statute was enacted."<sup>15</sup> The court also noted that Indiana cases, decided before that statute, had held "that when a broker made application for insurance, and the insurance policy was issued, the broker was the agent of the insurer and could bind it within the scope of his authority."<sup>16</sup>

In spite of its holding, the court apparently found that the issue of the agent's authority to bind the insurance company is a question of fact. In reviewing the record of the lower court, the court of appeals held that, due to the lack of evidence concerning George's authority, a genuine issue of fact existed concerning such authority, and thus remanded the case to the trial court for further proceedings.<sup>17</sup>

On the issue of whether the policy covered Shaver even though its status was listed as contract seller rather than mortgagee, the court of appeals did not disagree with Shaver's contention that mere mislabeling of its status did not preclude coverage and noted that an Indiana Supreme Court decision greatly reduced the distinction between the two.<sup>18</sup> However, the court determined that it was unnecessary to address the question because, "Shaver was not listed as either contract seller or mortgagee *in the declarations*,"<sup>19</sup> and it, therefore, could not find "that coverage was provided as a matter of law."<sup>20</sup>

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11. 169 Ind. App. 453, 349 N.E.2d 271 (1976).

12. *Rodriguez*, at 1324.

13. *Id.* (quoting IND. CODE § 27-1-15-1(d) (1982)).

14. *Id.* (citing IND. CODE § 27-1-15.5-1 to -20 (1982)).

15. *Id.*

16. *Id.* (citing *Johnson, Ins. Comm'r v. Schrepferman*, 67 Ind. App. 606, 119 N.E. 494 (1918); *Indiana Ins. Co. v. Hartwell*, 123 Ind. 177, 24 N.E. 100 (1889); 16 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 8731, at 375 (1981)).

17. *Rodriguez*, 496 N.E.2d at 1324-25.

18. *Id.* at 1324.

19. *Id.* (emphasis in original).

20. *Id.*



On Petition for Rehearing by Shaver Motors, the Indiana Court of Appeals reversed itself.<sup>21</sup> The court held that under the law enunciated in the landmark decision of *Skendzel v. Marshall*<sup>22</sup> a contract seller and a mortgagee are substantially the same.<sup>23</sup> Therefore, the court refused to allow Aetna to distinguish between the two. Because Shaver was listed in the policy as a contract seller, the court found that was sufficient for Shaver to have rights under the policy.<sup>24</sup>

After this turn of events, Aetna petitioned to transfer the case to the Indiana Supreme Court. On transfer, the supreme court reversed both of the earlier court of appeals opinions and affirmed the original trial court decision.<sup>25</sup> In doing so, the court ignored the factual issues that were raised by the court of appeals in its first opinion and ruled as a matter of law "that in Indiana when a broker makes application for insurance and the insurance policy is issued, the broker is the agent of the insurer and can bind it in the scope of his authority."<sup>26</sup>

The supreme court may have erred in relying upon the reasoning of the court of appeals' first decision. At the time of the original appeal, the court of appeals refused to acknowledge the law of *Stockberger v. Meridian Mutual Insurance Co.*<sup>27</sup> and *Automobile Underwriters, Inc. v. Hitch*<sup>28</sup> because it felt that those cases were predicated upon the earlier Indiana Code section which made an insurance broker an agent of the insured for all purposes connected with the procurement of insurance.<sup>29</sup> However, in rejecting *Stockberger* and *Hitch* the court of appeals misread *Hitch*.

In *Hitch*, the court had stated that an agent who represents several insurance companies or works on behalf of more than one agent is considered an insurance "broker."<sup>30</sup> The court went on to state the "general rule" that "an insurance broker can be considered an agent

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21. Aetna Ins. Co. v. Rodriguez, 504 N.E.2d 1030 (Ind. Ct. App. 1987), *rev'd*, 517 N.E.2d 386 (Ind. 1988).

22. 261 Ind. 226, 301 N.E.2d 641 (1973), *cert. denied*, 415 U.S. 921 (1974).

23. 504 N.E.2d at 1034.

24. *Id.* The Court's ruling flies in the face of the traditional reasons raised by insurance companies for distinguishing between land contract sellers and mortgagees. *See, e.g., Lakeshore Bank & Trust Co. v. United Farm Bureau Mut. Ins. Co.*, 474 N.E.2d 1024 (Ind. Ct. App. 1985); *Insurance Co. of N. Am. v. Nicholas*, 259 Ark. 390, 533 S.W.2d 204 (1976).

25. Aetna Ins. Co. v. Rodriguez, 517 N.E.2d 386 (Ind. 1988).

26. *Id.* at 388 (citing *Indiana Ins. Co. v. Hartwell*, 123 Ind. 177, 24 N.E. 100 (1890)).

27. 182 Ind. App. 566, 395 N.E.2d 1272 (1979).

28. 169 Ind. App. 453, 349 N.E.2d 271 (1976).

29. *Rodriguez*, 496 N.E.2d at 1324 (citing IND. CODE § 27-1-15-1(d) (1982)).

30. 169 Ind. App. at 459, 349 N.E.2d at 276 (citing 16 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 8732 (1968)).

only for the purposes of delivering policies and collecting premiums thereon. The insurer would not be bound, ordinarily, by the mistakes or negligence of a broker."<sup>31</sup> After adopting the "general rule," the *Hitch* court stated "moreover" that an existing Indiana statute made an insurance broker the agent of the insured.<sup>32</sup> In using the term "moreover," the court clearly implied that it was adopting the general rule and that it was simply referring to the statute as *additional* support for adopting the general rule.

When the court of appeals ruled in the first *Aetna* case that *Hitch* and *Stockberger* were based upon the earlier Indiana statute,<sup>33</sup> the court overlooked the fact that *Stockberger* had also adopted general common law when it held that an insurance broker was the agent of the insured for all purposes related to the procurement of coverage.<sup>34</sup> The court did not have to go back to the 1880's to discover the common law in Indiana in this area.

Even if the court of appeals erred in its first opinion, it at least left open the possibility that there could be a question of fact in each particular case as to the broker's authority and whether he is an agent of the company or an agent of the insured. However, when the Indiana Supreme Court ruled as it did, the court, in essence, established as a *rule of law* that an insurance broker will always be the agent of the insurance company for purposes of procuring insurance for a proposed insured.<sup>35</sup>

This recent ruling by the Indiana Supreme Court takes Indiana out of the mainstream of American law on this particular issue.<sup>36</sup> The prevailing rule across the country is based upon the well-understood fact that ordinarily a person is the agent of the first person who hires him.<sup>37</sup> Furthermore, Indiana and most other states have long held that when a broker works with a proposed insured to assist him in procuring insurance, a fiduciary relationship arises wherein the agent has a duty to use reasonable care and due diligence to procure adequate insurance

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31. *Hitch*, 169 Ind. App. at 460, 349 N.E.2d at 276 (citing *Metropolitan Inter-Ins. Exch. v. Anthony*, 1 Ill. App. 3d 612, 275 N.E.2d 296 (1971)); *Kenilworth Ins. Co. v. Chamberlain*, 131 Ill. App. 2d 975, 269 N.E.2d 317 (1971); *Taylor v. Crowe*, 444 Pa. 471, 282 A.2d 682 (1971); 16 J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 8730 (1968).

32. 169 Ind. App. at 460, 349 N.E.2d at 277 (citing IND. CODE § 27-1-15-1(d) (1982)).

33. 496 N.E.2d 1321 (Ind. Ct. App. 1986), *vacated*, 504 N.E.2d 1030 (Ind. Ct. App. 1987), *rev'd*, 517 N.E.2d 356 (Ind. 1988).

34. 182 Ind. App. 566, 576, 395 N.E.2d 1272, 1278-79 (1979).

35. *Aetna Ins. Co. v. Rogriguez*, 517 N.E.2d 386 (Ind. 1988).

36. *See generally* 3 R. RHODES, *COUCH ON INSURANCE* 2d § 25:95 (1984).

37. *Id.*



to meet the needs of the proposed insured.<sup>38</sup> In this day and age when major insurance brokers can select from dozens of insurance companies when placing coverage for a proposed insured, it no longer makes sense that the acts or omissions of the broker should be imputed to a particular company based upon a rule such as the one recently enunciated by the Indiana Supreme Court.

After *Hitch* and *Stockberger*, there had been a degree of certainty in cases involving acts or omissions of brokers because attorneys could rely upon the rule that a broker was the agent of the insured for purposes of procuring coverage. As a result of *Rodriguez*,<sup>39</sup> this author predicts that litigation in this area will take on sizeable proportions because cases will now be more fact-sensitive than ever before. There will be a great deal more attention devoted to the past relationship between the broker and the company. Attorneys and judges will no longer be able to look to the relatively easy question of whether a particular insurance agency was a captive agency of a company or whether the agency was in a position to write insurance through several companies.

### III. UNINSURED MOTORIST COVERAGE—DEFINITION OF “ALIGHTING FROM” AN AUTOMOBILE

One of the bright spots in insurance law during the survey period was the case of *Miller v. Loman*.<sup>40</sup> In *Miller*, the Indiana Court of Appeals provided excellent guidelines on how to determine when a person is “alighting from” an automobile for purposes of uninsured motorist coverage.<sup>41</sup> While other Indiana cases have touched upon the meaning of “alighting from” an automobile, no court has previously provided such helpful advice on how to approach this problematic subject.<sup>42</sup>

The *Miller* case arose from an accident which occurred on December 20, 1983. The injured party, Steve Miller, and his wife were being driven to the airport by John and Laura Perkinson. As they were driving toward the airport, their truck struck a chuckhole, causing the truck's muffler to break loose and fall into the street. Mr. Perkinson continued driving until he was able to turn around to retrieve the muffler. When the truck

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38. *Id.* §§ 25.93-25.99.

39. 517 N.E.2d 386 (Ind. 1988).

40. 518 N.E.2d 486 (Ind. Ct. App. 1987).

41. The court also addressed the meanings of “loading or unloading” a vehicle and “maintenance or use” of a vehicle. *Id.* at 492-93. However, the court's rulings on these topics were not significant enough to warrant discussion in this Article.

42. For earlier treatment of the subject in Indiana, see, e.g., *State Farm Mut. Auto. Ins. Co. v. Barton*, 509 N.E.2d 244 (Ind. Ct. App. 1987); *Michigan Mut. Ins. Co. v. Combs*, 446 N.E.2d 1001 (Ind. Ct. App. 1983); *United Farm Bureau Mut. Ins. Co. v. Pierce*, 152 Ind. App. 387, 283 N.E.2d 788 (1972).

stopped near the muffler, Miller offered to retrieve the muffler. Perkinson warned Miller that the muffler might be hot and that he should kick it off to the side of the road so that Perkinson could find it on the trip back from the airport.<sup>43</sup>

After exiting the truck, Miller crossed two lanes of the street and reached the muffler at a location about thirty feet away from the truck. The muffler was one to two feet from the berm of the road. As Miller was kicking the muffler off the road, he was struck and seriously injured by a car that was being driven by an uninsured motorist.<sup>44</sup>

Subsequently, Miller made an uninsured motorist claim against Perkinson's automobile liability insurance carrier, Allstate Insurance Company. The case found its way to the Indiana Court of Appeals after the trial court entered summary judgment for Allstate reasoning that Miller was not "getting into or out of an automobile" when the accident happened and was, therefore, not covered by the insurance policy.<sup>45</sup>

In the court of appeals, Allstate argued that the court should apply a time and distance analysis that would limit coverage to those accidents occurring within the area in which a person normally subjects himself to the risks resulting from exiting an automobile.<sup>46</sup> Because Miller was approximately thirty feet away from the truck when the accident happened, Allstate argued that Miller was past the point where he was subject to the usual risks arising from exiting an automobile.<sup>47</sup>

Miller agreed that time and distance are factors which may be considered by a court in deciding whether to extend coverage in a given situation. However, he also argued that time and distance should not be the only factors in determining an injured party's relationship with the automobile.<sup>48</sup>

To analyze the issue, the court looked to cases from other states. In doing so, the court found three approaches to determining whether a person is "alighting from" an automobile when an accident occurs.<sup>49</sup>

The first line of cases is in accord with Allstate's position. Several cases held that the proper analysis focuses on the relationship between the injured person and the vehicle, with specific reference to two factors: the amount of time lapsing between exit and injury and the *distance* from the vehicle to the location of the accident.<sup>50</sup>

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43. 518 N.E.2d at 487.

44. *Id.*

45. *Id.* at 487-88.

46. *Id.* at 488.

47. *Id.*

48. *Id.*

49. *Id.* at 488-91.

50. 518 N.E.2d at 488-89 (citing *Menchaca v. Hiatt*, 59 Cal. App. 3d 117, 130



The second line of cases reviewed by the court involved jurisdictions which had taken a time and distance approach but had additionally examined the intent of the injured person, specifically any overt acts indicative of an intent to "undertake a new direction or activity."<sup>51</sup> Illustrative of this approach is a statement made by the Florida District Court of Appeals in the case of *Fidelity & Casualty Co. v. Garcia*<sup>52</sup> where the court stated: "We think that a rational limit to the activity that may be said to be encompassed within the term 'alighting from' is the time and place at which the insured shows an intention, evidenced by an overt act based on that intention, to undertake a new direction or activity."<sup>53</sup>

Finally, the court noted a third line of jurisdictions which place reliance upon whether, prior to an accident, a person "alighting from" a vehicle has reached a zone or location of safety from the risks of exiting a vehicle.<sup>54</sup> For example, if a passenger in an automobile exits from the passenger side of the car, crosses in front of the insured vehicle to reach the opposite curb and is struck by an uninsured vehicle prior to reaching the opposite curb, jurisdictions which follow the "zone of safety" approach would find coverage under the "alighting from" policy language. The rationale of such a finding is based on the premise that crossing a street to reach a position of safety is a natural and reasonably foreseeable activity when one alights from a car.<sup>55</sup>

After reviewing the three approaches taken by other jurisdictions, the court noted that a very recent Second District Court of Appeals case addressed the issue.<sup>56</sup> In *State Farm Mutual Automobile Insurance Co. v. Barton*<sup>57</sup>, the injured plaintiff was riding with a friend who intentionally fishtailed the car and crashed into a utility pole. The accident caused live wires to fall at the passenger side of the car. The plaintiff

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Cal. Rptr. 607 (1976); *Crear v. Nat'l. Fire & Marine Ins. Co.*, 469 So. 2d 329 (La. Ct. App. 1985); *Day v. Coca Cola Bottling Corp.*, 420 So. 2d 518 (La. Ct. App. 1982); *Breard v. Haynes*, 394 So. 2d 1282 (La. Ct. App. 1981)).

51. 518 N.E.2d at 489 (citing *Government Employees Ins. Co. v. Keystone Ins. Co.*, 442 F. Supp. 1130 (E.D. Pa. 1977); *State Farm Mut. Auto Ins. Co. v. Yanes*, 447 So. 2d 945 (Fla. Dist. Ct. App. 1984); *Fidelity & Casualty Co. of N.Y. v. Garcia*, 368 So. 2d 1313 (Fla. Dist. Ct. App. 1979)).

52. 368 So. 2d 1313 (Fla. Dist. Ct. App. 1979).

53. *Id.* at 1315.

54. 518 N.E.2d at 489-90 (citing *State Farm Mut. Ins. Co. v. Holmes*, 175 Ga. App. 655, 333 S.E.2d 917 (1985); *Joins v. Bonner*, 28 Ohio St. 3d 398, 504 N.E.2d 61 (1986)).

55. *See, e.g., Joins v. Bonner*, 28 Ohio St. 3d 398, 504 N.E.2d 61 (1986).

56. 518 N.E.2d at 490 (citing *State Farm Mut. Auto. Ins. Co. v. Barton*, 509 N.E.2d 244 (Ind. Ct. App. 1987)).

57. 509 N.E.2d 244 (Ind. Ct. App. 1987).

had exited the car from the driver's door and had made it safely to the roadway. Shortly thereafter, the plaintiff returned to the car to help push it free. After unsuccessful attempts to push the car, the plaintiff started to walk away but was injured when he accidentally touched one of the downed lines about three feet from the car.<sup>58</sup>

Judge Shields applied what appears to be a time, distance, and zone of safety approach in finding that there was no coverage.<sup>59</sup> She found that when the occupants of the vehicle had gotten out of the car and safely away from it after the initial impact with the pole, they had completed the process of "alighting from" the vehicle. Therefore, when the injury occurred, the plaintiff was embarking upon a new and distinct course of conduct.<sup>60</sup>

After reviewing the various approaches taken by other states and after giving consideration to the *Barton* case, the *Miller* court decided to incorporate all of the factors that had been used in other jurisdictions. The court stated:

We believe the proper determination of whether an individual is "alighting from" or "getting out of" an automobile requires the examination of several factors which may establish the existence of a relationship between the individual and the insured automobile. These factors include: the distance between the accident and the automobile; the time separating the accident and the exit from the automobile; the individual's opportunity to reach a zone of safety; and the individual's intentions in relation to the automobile. These factors will, of course, have greater or lesser weight depending upon the circumstances of each individual case. There may be instances in which one of the factors may be determinative, such as where the accident occurs at such a great distance from the automobile as to render it unreasonable to assume the process of alighting had not been completed.<sup>61</sup>

Based upon the cited factors, the court ruled that Miller was not "alighting from" the vehicle when the accident occurred. Because he was thirty feet away from the truck and kicking a muffler when the automobile struck him, and because he evidenced no intention to reach a location of safety, the court found that he was engaging in conduct that was distinct from any acts necessary to exit a vehicle.<sup>62</sup>

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58. *Id.* at 245-46.

59. *Id.* at 247-48.

60. *Id.* at 248.

61. 518 N.E.2d at 491-92.

62. 518 N.E.2d at 492 (citing *Carta v. Providence Wash. Indem. Co.*, 143 Conn. 372, 122 A.2d 734 (1956)).



Some may criticize *Miller v. Loman*<sup>63</sup> because the court has outlined an approach which will make every case fact-sensitive. However, any review of the cases that have come before will demonstrate that each was fact-sensitive anyway. Now, judges and practitioners have reasonably clear guidelines with which to analyze the facts of each case. Furthermore, the court, by sustaining the trial court's summary judgment, has made it clear that such factors as the reasonableness of time and distance, intent, and zone of safety can be determined by the judge as a matter of law.

#### IV. COOPERATION CLAUSE

One of the more startling cases during the survey period struck a blow to the traditional insurance company defense of failure to cooperate.<sup>64</sup> In the case of *Smithers v. Mettert*,<sup>65</sup> the Indiana Court of Appeals made it clear that an automobile liability insurance carrier may not deny liability coverage to an insured for failure to cooperate unless the insurer has done everything humanly possible to make the insured cooperate.

The *Smithers* case arose from an automobile accident which occurred on April 25, 1979, when James C. Mettert's car swerved off the road and overturned. One of the passengers in the car, Roger Smithers, was injured. At the time of the accident, Mettert carried automobile liability insurance through Milwaukee Insurance Company. The policy was a standard automobile liability contract which contained a standard cooperation clause.<sup>66</sup>

Some time after the accident, Smithers retained an attorney, and a claim was submitted to Milwaukee for Smithers' injuries. Milwaukee, in turn, retained an independent adjuster to investigate the claim. In January and February of 1980, the adjuster sent two letters to Mettert at his Indiana address, but there was no immediate response.<sup>67</sup> In March, Mettert answered the adjuster's letters and gave a statement about the accident.<sup>68</sup> During that conversation, Mettert stated that he was leaving for California and did not have the time to discuss the accident.<sup>69</sup>

A year later in February 1981, Smithers filed suit against Mettert. Milwaukee retained counsel who entered an appearance and answered the lawsuit on behalf of Mettert in May 1981. Thereafter, the defense

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63. 518 N.E.2d 486 (Ind. Ct. App. 1987).

64. *Smithers v. Mettert*, 513 N.E.2d 660 (Ind. Ct. App. 1987).

65. *Id.*

66. *Id.* at 661-62.

67. *Id.* at 661.

68. *Id.*

69. *Id.* at 665.

counsel attempted to reach Mettert by sending letters by regular mail and certified mail to out-of-state addresses. Neither letter was returned, and counsel did not receive a response from Mettert.<sup>70</sup> Thereafter, defense counsel unsuccessfully attempted to contact Mettert through Mettert's mother.

When counsel had not heard from Mettert by September of 1981, he requested investigative assistance from Milwaukee Insurance. At that point, Milwaukee hired an investigative agency to locate Mettert. In November, defense counsel received an investigative report indicating that Mettert was temporarily living with his brother and sister-in-law in Florida. The report included Mettert's address as well as a phone number.<sup>71</sup>

Defense counsel continued to attempt to contact Mettert by sending a certified letter to the Florida address. The letter came back unclaimed. Defense counsel also attempted to call Mettert in Florida without success. A second certified letter was sent in November of 1982 to the Florida address. Duplicate letters were also sent to another Florida address and to Mettert's mother in Indiana. Finally, when no response had been received from Mettert, defense counsel petitioned the court to withdraw his appearance on behalf of Mettert because of his lack of success in contacting Mettert.<sup>72</sup>

After defense counsel was granted leave to withdraw, the court entered a default judgment for Smithers and against Mettert. Smithers subsequently filed a Motion for Proceedings Supplemental and initiated a garnishment action against Milwaukee Insurance. Nothing became of the garnishment motion until November 1986 when the trial court denied Smithers' motion for payment of insurance proceeds from Milwaukee.<sup>73</sup> Smithers appealed this decision.

To support its denial of payment, Milwaukee relied upon the co-operation clause in the policy which stated in pertinent part that "[t]he insured shall cooperate with the company and upon the company's request, assist in making settlements, in the conduct of suits . . . and the insured shall attend hearings and trials and assist in securing and giving evidence and obtaining the attendance of witnesses."<sup>74</sup>

The court of appeals held that in order for Milwaukee to prevail on its defense of failure to cooperate, it had to prove three elements. First, the company has to establish that the insured breached the co-operation clause by an intentional and willful failure to cooperate and

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70. *Id.* at 661.

71. *Id.*

72. *Id.*

73. *Id.* at 661-62.

74. *Id.* at 662.



attend trial.<sup>75</sup> Second, the company has to prove that it used good faith efforts and due diligence in attempting to gain the insured's cooperation.<sup>76</sup> Third, the company was obligated to prove that the insured's failure to cooperate prejudiced the company in defending the insured.<sup>77</sup>

In spite of all of Milwaukee's efforts, the court found that it had failed to meet its burden of establishing intentional and willful failure to cooperate. Although the court stated that there may have been sufficient evidence of Milwaukee's good faith efforts to gain cooperation from Mettert and sufficient evidence of prejudice to Milwaukee, the court found that there was no proof that Mettert had refused to respond to the company after being contacted by them.<sup>78</sup> Specifically, the court stated that "[a]bsence of a response alone does not indicate a refusal to cooperate."<sup>79</sup> The court also stated that "Metttert's absence from trial also does not establish an intentional and willfull failure to cooperate," especially since the action was filed subsequent to Mettert's "disappearance."<sup>80</sup> In a footnote, the court pointed out that Milwaukee had not attempted to subpoena or depose their insured. Furthermore, Milwaukee had not made any effort to contact Mettert in person.<sup>81</sup> Relying on these factors, the majority found that the cooperation clause did not support the trial court's order denying Smithers' garnishment of the insurance proceeds and reversed the trial court's finding.

This case should stand as a strong example for the insurance industry of the extent to which a company must go in attempting to obtain an insured's cooperation. Because the absence of a response is not enough to indicate a refusal to cooperate, a company is going to have to resort to attempting personal contact with a recalcitrant insured. Furthermore, if a company knows the whereabouts of its insured, this case suggests that the company may have to subpoena or attempt to depose the insured.

Although the *Smithers* case may seem extreme, it is not without support in Indiana law. At least one earlier case has pointed out that

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75. *Id.* (citing *Newport v. MFA Ins. Co.*, 448 N.E.2d 1223, 1227 (Ind. Ct. App. 1983); 8 J. APPLEMAN, *INSURANCE LAW & PRACTICE* § 4784 (1981)).

76. 513 N.E.2d at 662 (citing *Mutual Automobile Ins. Co. v. Walker*, 382 F.2d 548, 551 (7th Cir. 1967); *Potomac Ins. Co. v. Stanley*, 281 F.2d 775, 781 (7th Cir. 1950)); *Newport v. MFA Ins. Co.*, 448 N.E.2d 1223, 1227 (Ind. Ct. App. 1983).

77. 513 N.E.2d at 662 (citing *Miller v. Dilts*, 463 N.E.2d 257, 261 (Ind. 1984); *Motorists Mut. Ins. Co. v. Johnson*, 139 Ind. App. 622, 628, 218 N.E.2d 712, 715 (1966)).

78. 513 N.E.2d at 663. The court noted that when Mettert had, in fact, received notification, he responded and was cooperative. The court determined that the evidence established only that Milwaukee attempted to contact Mettert, *not* that Mettert had refused to cooperate. *Id.*

79. *Id.*

80. *Id.*

81. *Id.* n.1.

liability insurance is now mandatory in many states. Such insurance is meant not only to protect the insured, but is also intended to protect members of the public who may suffer injuries through another's negligence. Thus, unless the courts require insurance companies to provide complete proof of diligent efforts to locate insureds, the practical usefulness of insurance policies would be diluted because without such "strict" requirements a company could walk away from coverage simply by showing the disappearance or nonresponsiveness of its insured.<sup>82</sup>

## V. MISCELLANEOUS CASES

### A. *Permissive Use of Automobile*

In the case of *National Mutual Insurance Co. v. Eward*,<sup>83</sup> the Indiana Court of Appeals gave broad meaning to an omnibus clause in an automobile insurance policy. The court held that the first permissive user of a vehicle has implied permission to loan the vehicle to a second permissive user unless the vehicle owner has expressly prohibited the first user from loaning the vehicle.<sup>84</sup>

The *Eward* case arose from a very interesting factual situation. The vehicle in question, a van, was owned by Jack A. McClees Painting and was insured by National Mutual Insurance Company. McClees had a painting foreman by the name of Darrell Jones. In 1984, Jones voiced the possibility that he would leave the company for a better-paying job. To induce Jones to stay, McClees provided Jones with a company van that Jones could use virtually as his own. McClees placed no restrictions on how and when Jones could use the van, and Jones obligated himself to take care of minor repairs. For a period of time prior to the accident, Jones drove the van to work, used it on personal business and dates, and paid for fuel, a new tire, and radiator repairs.<sup>85</sup>

At some later date, McClees instructed Jones that he did not want anyone drinking alcohol and then driving the van. However, after placing that restriction on Jones, McClees took all of his work crew out for food and alcoholic beverages. McClees also knew that Jones and a friend from work would sometimes stop for beer after work. He also knew that the van was Jones' only means of transportation.<sup>86</sup>

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82. See *Newport v. MFA Ins. Co.*, 448 N.E.2d 1223 (Ind. Ct. App. 1983) (citing *Pennsylvania Thresherman & Farmer's Mut. Casualty Ins. Co. v. Owens*, 238 F.2d 549 (4th Cir. 1956)).

83. 517 N.E.2d 95 (Ind. Ct. App. 1987).

84. *Id.* at 99.

85. *Id.* at 97.

86. *Id.*



One evening a couple of months after McClees imposed the alcohol and driving restriction, Jones went drinking with Jack Eward, the brother of Steven Eward. At some point during the evening, Steven Eward joined the two of them and, when the three of them prepared to leave, Jones asked Steven to drive the van because he was the least intoxicated. As they left, Steven drove away in the van and then realized that he had left Jones back on the sidewalk. As he was backing the van to get Jones, he struck and injured Jones.<sup>87</sup>

Based upon these facts, the trial court found that Steven Eward had the implied permission of Jack McClees to drive the van and, therefore, was insured under McClees' policy. Eward and the trial court relied on the Seventh Circuit Court of Appeals' findings in *Arnold v. State Farm Mutual Automobile Insurance Co.*,<sup>88</sup> where it was noted that:

[U]nder Indiana law, a policy that contains an omnibus clause extends coverage to a permittee of the owner . . . . [C]overage [is] properly extended to a second permittee under an omnibus clause in a case which there was implied consent by the owner to a friend of the original permittee.<sup>89</sup>

The trial court found that since McClees did not expressly or impliedly forbid Jones from allowing another to drive, consent could be implied.<sup>90</sup>

National argued that for Eward to be covered under the policy, he had to be using the van for Jones' benefit *and* within the scope of McClees' permission to Jones. Relying on this assertion, National claimed that since Eward was as drunk as Jones and since McClees had restricted Jones' use of the van while drinking, Eward's use of the van was outside the scope of the permission originally given to Jones and, therefore, coverage was precluded.<sup>91</sup> The court disagreed and stated:

[T]he fact that a permittee used the vehicle for a purpose not contemplated by the owner when he gave permission does not exclude the permittee from coverage, and the extent of the deviation from the original purpose is not material.<sup>92</sup>

The trial court also concluded that McClees had waived any restriction concerning use of the van and alcohol consumption because of his conduct in taking Jones and others for drinks, and because McClees knew that

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87. *Id.* at 97-98.

88. 260 F.2d 161 (7th Cir. 1958).

89. 517 N.E.2d at 99 (citing *Arnold State Farm Mut. Auto. Ins. Co.*, 260 F.2d 161 (7th Cir. 1958)).

90. 517 N.E.2d at 99.

91. *Id.*

92. *Id.*

Jones had no other transportation besides the van.<sup>93</sup> The court of appeals agreed, holding: "[H]ere, McClees initially placed no restrictions on how Jones could use the van. Therefore, under Indiana law, the trial court could properly conclude Eward had implied permission, and that he came under the protection of the policy."<sup>94</sup> The court also found that the trial court had the discretion to conclude that, on the basis of his conduct, McClees had waived any restriction concerning drinking and driving.<sup>95</sup>

The broad ruling by the court in this case suggests that the courts are going to find implied permission for the second permittee of a vehicle anytime that the owner of a vehicle loans it without placing restrictions on who may use it. Although the relevant Indiana statute<sup>96</sup> does not require such a broad reading,<sup>97</sup> the *Eward* case is another example of the fact that courts are recognizing a public policy in favor of extending liability coverage for the protection of injured third parties.<sup>98</sup>

### *B. Denial of Liability Coverage for Insured's Intentional Acts*

In *National Mutual Insurance Co. v. Eward*,<sup>99</sup> discussed above, the insurance company unsuccessfully argued that coverage should be denied to Steven Eward because Eward was intoxicated at the time of the accident.<sup>100</sup> Although the company's argument was unsuccessful, the novel approach taken by the company deserves mention.

National's policy required it to pay any sums the insured became legally obligated to pay "caused by an *accident*."<sup>101</sup> Under the terms of the policy, an accident is defined as "continuous or repeated exposure to the same conditions resulting in bodily injury or property damage the insured neither expected nor intended."<sup>102</sup> National argued that because Eward was driving while intoxicated when he injured Jones, his conduct was willful and wanton under Indiana law.<sup>103</sup> National's argument

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93. *Id.* at 97-99.

94. *Id.* at 99 (citing *Arnold v. State Farm Mut. Auto. Ins. Co.*, 260 F.2d 161 (7th Cir. 1958); *American Employers' Ins. Co. v. Cornell*, 225 Ind. 559, 76 N.E.2d 562 (1948)).

95. 517 N.E.2d at 99.

96. IND. CODE § 27-1-13-7 (1988).

97. 517 N.E.2d at 98 (citing *Standard Mut. Ins. Co. v. Pavelka*, 580 F. Supp. 224 (S.D. Ind. 1983)).

98. *See, e.g., Newport v. MFA Ins. Co.*, 448 N.E.2d 1223, 1229 (Ind. Ct. App. 1983).

99. 517 N.E.2d 95 (Ind. Ct. App. 1987).

100. *Id.* at 99-100.

101. *Id.* at 100 (emphasis in original).

102. *Id.* (emphasis omitted).

103. *Id.*



was based upon the case of *Williams v. Crist*<sup>104</sup> in which the Indiana Supreme Court held that if a driver was intoxicated at the time of the accident, the intoxication was sufficient to show willful or wanton misconduct under the Indiana Guest Statute.<sup>105</sup> National argued that the legal definition of willful was the same as the definition of the words "intended or expected" as used in the policy definition of an accident.<sup>106</sup>

The Indiana Court of Appeals ignored National's argument entirely. Rather, the court employed an analysis that reviewed the nature of an insurance contract, the reasonable expectations of the parties about the coverage afforded, and the ordinary meaning of the word "accident."<sup>107</sup> Paradoxically, after reciting the accepted definition of the term "accident," the court found that National's policy covered "only acts which are *not* motivated by an intent and purpose to injure,"<sup>108</sup> but then emphasized the fact that National's policy did not mention the word "negligence."<sup>109</sup>

The court's analysis of the meaning of the word "accident" offered no guidance. Because the word "negligence" was not contained in the policy, the court reasoned that there was no contractual limitation as to what type of accident would be afforded coverage.<sup>110</sup> The court concluded:

[T]he contract does not expressly exclude damages from an accident in which the owner or driver is under the influence of alcohol. If there was to be an exception or limitation in this respect, the policy should contain the language to put the holder on notice of such limitation.<sup>111</sup>

As a matter of public policy, the court probably was correct in holding that a standard automobile liability policy should cover accidents caused by intoxication unless the policies contain specific exclusions. However, the court's approach in reaching its conclusion was contrived. If anything, the court's analysis in this case is indicative of the corner that the courts have backed themselves into by their holdings that driving

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104. 484 N.E.2d 576 (Ind. 1985).

105. *National Mut. Ins. Co. v. Eward*, 517 N.E.2d 95, 100 (citing *Williams v. Crist*, 484 N.E.2d 576 (Ind. 1985); IND. CODE § 9-3-3-1 (1982)).

106. *Id.*

107. *Id.* (citing *Protective Life Ins. Co. v. Coca-Cola Bottling-Indianapolis-Inc.*, 467 N.E.2d 786 (Ind. Ct. App. 1984); *Northland Ins. Co. v. Crites*, 419 N.E.2d 164 (Ind. Ct. App. 1981)).

108. 517 N.E.2d at 100-01.

109. *Id.* at 101.

110. *Id.*

111. *Id.* (citing *Rothman v. Metropolitan Casualty Ins. Co.*, 134 Ohio St. 241, 16 N.E.2d 417 (1938)).

while intoxicated is willful and wanton conduct as a matter of law.<sup>112</sup>

*C. Liability of Insured for the Insured's Company's Claim Handling Practices*

During the survey period, the Indiana Court of Appeals had the opportunity to decide whether an insured should be held accountable for the acts or omissions of his liability insurance carrier during the claim handling process. In *Eichler v. Scott Pools, Inc.*,<sup>113</sup> one of Scott Pools' company vehicles was damaged when Thomas Eichler (a customer) backed into the vehicle in the company parking lot. Scott Pools made claim against Eichler but was unable to reach a satisfactory settlement with Eichler's insurance company, State Farm.<sup>114</sup> Subsequently, Scott Pools filed suit in small claims court against Eichler but did not name State Farm as a party. Scott Pools sought compensatory damages and attorney fees.<sup>115</sup>

After a trial, the court entered a judgment in which it awarded compensatory damages; found that Eichler, through State Farm, had dealt with Scott Pools in bad faith; found that State Farm's conduct warranted punitive damages; and that Scott Pools was not entitled to attorney fees. The judgment was for \$546.42 in compensatory damages and \$2,453.58 in punitive damages.<sup>116</sup> The award of punitive damages appeared to be based on the theory that State Farm's failure to settle with Scott Pools "was imputable to the Eichlers because State Farm was the Eichlers' agent."<sup>117</sup>

The Indiana Court of Appeals wasted no time in finding that the trial court had erred. The court cited the long-standing rule that "[a] claimant has no standing to sue a defendant's insurer for handling a claim negligently or in bad faith."<sup>118</sup> Furthermore, the court noted that there is no duty on the part of an insurer to settle a third-party claim, nor is any duty owed to a claimant on a third-party beneficiary theory.<sup>119</sup>

Since State Farm had not been named as a party, the foregoing considerations were not directly in issue. However, the court noted that

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112. See, e.g., *Obremski v. Henderson*, 497 N.E.2d 909 (Ind. 1986) (drunk driver was willful and wanton for purposes of treble damages statute); *Williams v. Crist*, 484 N.E.2d 576 (Ind. 1985) (drunk driver was willful and wanton for purpose of guest statute).

113. 513 N.E.2d 665 (Ind. Ct. App. 1987).

114. *Id.* at 666.

115. *Id.*

116. *Id.*

117. *Id.* at 667 (footnote omitted).

118. *Id.* (citing *Bennett v. Slater*, 154 Ind. App. 67, 289 N.E.2d 144 (1972)).

119. 513 N.E.2d at 667 (citing *Martin v. Levinson*, 409 N.E.2d 1239 (Ind. Ct. App. 1980); *Winchell v. Aetna Life & Casualty Ins. Co.*, 182 Ind. App. 261, 394 N.E.2d 1114 (1979)).



when an insurer investigates and defends a claim on behalf of its insured, the insurer retains complete control over the defense of the claim and settlement.<sup>120</sup> Therefore, the court held that the existence of insurance coverage does not make the insurance representative an agent for the insured when the insurer is handling settlement discussions or defense matters.<sup>121</sup> Rather, the insurer acts similarly to an independent contractor.<sup>122</sup> Decisions of this nature continue to protect insureds from liability for their insurer's actions in situations such as settlement negotiations in which the insured does not participate nor have control over the insurer.

## VI. STATUTORY AMENDMENTS

### A. *Underinsured Motorist Coverage*

During 1987, the Indiana State Legislature amended the existing statutes concerning uninsured motorist coverage<sup>123</sup> by adding mandatory coverage for "underinsured motorists."<sup>124</sup> The term "underinsured motor vehicle" is defined as

[a]n insured motor vehicle where the limits of coverage available for payment to the insured under all bodily injury liability policies covering persons liable to the insured are less than the limits for the insured's underinsured motorist coverage at the time of the accident, but does not include an uninsured motor vehicle as defined in subsection (a).<sup>125</sup>

Prior to the enactment of the statute, some companies had already been providing underinsured motorist coverage in Indiana. However, disputes arose concerning interpretation of policy limits and the correct definition of an underinsured motorist.<sup>126</sup> For that reason, the legislature expressly provided that underinsured motorist coverage must be afforded with limits of liability identical to those contained in the bodily injury liability portions of an insured's policy.<sup>127</sup> Further, the statutes provide a specific definition of how to determine whether a person is in fact "underinsured" in a given situation.<sup>128</sup>

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120. 513 N.E.2d at 668 (citing 44 AM. JUR. 2D *Insurance* § 1393, at 326 (1982)).

121. 513 N.E.2d at 668 (citing *Martin v. Levinson*, 409 N.E.2d 1239, 1245 (Ind. Ct. App. 1980)).

122. 513 N.E.2d at 668.

123. IND. CODE §§ 27-7-5-2 to -6 (1988).

124. *Id.* § 27-7-5-2.

125. *Id.* § 27-7-5-4(b).

126. *See, e.g., Meridian Mut. Ins. Co. v. Richie*, 517 N.E.2d 1265 (Ind. Ct. App. 1988).

127. IND. CODE § 27-7-5-2 (1988).

128. *Id.* § 27-7-5-4(b).

The advent of underinsured motorist coverage should be a good thing for those persons who have always carried limits substantially higher than the legal minimum of \$25,000/\$50,000.<sup>129</sup> Under the prior law, a seriously injured person who carried high uninsured motorist coverage limits was better off to get involved in an accident with an uninsured motorist than with a person who simply carried the minimum limits. That problem should no longer arise because mandatory underinsured motorist coverage will be carried in the same limits as a person's bodily injury liability coverage limits.

### *B. Unfair Claim Settlement Practices*

During the 1987 legislature, the statute defining unfair claims settlement practices<sup>130</sup> was amended to prohibit insurance companies, in negotiating insurance liability claims, from "ascribing a percentage of fault to a person seeking to recover from an insured party, in spite of an obvious absence of fault on the part of that person."<sup>131</sup> Although this author has not seen companies that have blatantly tried to apportion fault to persons who are free of fault, rumors abound in the industry that some companies were ascribing ten to fifteen percent fault to a motorist simply for being on the street. Apparently, the same rumors or examples found their way to the legislature and this amendment was the result.

### *C. Cancellation or Nonrenewal of Commercial Property and Casualty Insurance*

One additional amendment in 1987 which is noteworthy concerns a new chapter concerning Cancellation and Nonrenewal of Commercial Property and Casualty Insurance policies.<sup>132</sup> The new chapter requires an insurer to meet certain notice requirements prior to cancelling or refusing to renew a commercial liability insurance policy.<sup>133</sup> The time limitations relating to cancellation of a policy vary depending upon the circumstances. If the cancellation is caused by the insured's failure to pay a premium, the insurer must provide at least ten days notice.<sup>134</sup> When there has been a substantial change in the level of risk covered under the policy or the insured has failed to comply with reasonable safety recommendations or reinsurance of the insurance risk associated

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129. *Id.* § 9-2-1-15.

130. IND. CODE § 27-4-1-4.5 (1988).

131. *Id.* § 27-4-1-4.5(15).

132. IND. CODE §§ 27-1-31-1 to 27-1-31-3 (1988).

133. *Id.* §§ 27-1-31-2(b), -3.

134. *Id.* § 27-1-31-2(b)(3).



with the policy has been cancelled, the insurer is required to give at least forty-five days notice.<sup>135</sup> A minimum of twenty days notice must be given by the insurer if he plans to cancel the policy because the insured committed fraudulent or material misrepresentations.<sup>136</sup>

This amendment is believed to have been brought about as a result of certain insurance company underwriting practices which occurred during the recent "liability insurance crisis." There is no question that the notice provisions will offer greater fairness to companies in a day and age when certain types of commercial liability insurance are hard to find.

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135. *Id.* § 27-1-31-2(b)(1).

136. *Id.* § 27-1-31-2(b)(2).

# Developments in Indiana Employment Law

LELAND B. CROSS, JR.\*  
DOUGLAS CRAIG HANEY\*\*

## I. INTRODUCTION

During the survey period, several significant employment law issues were decided by the federal and state courts in Indiana. This Article will focus on only those court decisions that deal with "at-will" employment and those that deal with the exclusivity of the Indiana Workmen's Compensation Act as a bar to employee tort actions for workplace injuries.

## II. EMPLOYMENT AT WILL

### A. *Exceptions to the "At-Will" Rule Based in Tort*

In 1973, the Indiana Supreme Court created, in its *Frampton v. Central Indiana Gas Co.*<sup>1</sup> decision, a narrow exception to Indiana's "at-will" rule of employment. In *Frampton*, the court concluded that an employer's act of discharging an at-will employee in retaliation for the employee's filing a workmen's compensation claim constituted "an intentional, wrongful act on the part of the employer for which the injured employee is entitled to be fully compensated in damages."<sup>2</sup> The court based its ruling on a statutory mandate in the Indiana Workmen's Compensation Act,<sup>3</sup> which then stated that: "No contract or agreement, written or implied, no rule, regulation or other device shall, in any manner, operate to relieve any employer . . . of any obligation created by this act."<sup>4</sup> In the court's opinion, the discharge of an at-will employee for filing a workmen's compensation claim thus constituted a statutorily forbidden "device."<sup>5</sup>

Thus, with its *Frampton* decision, the Indiana Supreme Court carved out a narrow exception to the "at-will" rule in instances where an at-

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\* Partner, Ice Miller Donadio & Ryan, Indianapolis, Member of Indiana and Michigan Bars. B.A., Denison University, 1952; LL.B., University of Michigan, 1955.

\*\* Associate, Ice Miller Donadio & Ryan, Indianapolis. Member of Indiana and Wisconsin Bars. B.A., University of Wisconsin-Madison, 1978; J.D., University of Wisconsin School of Law, 1981; LL.M., Georgetown University, 1985.

1. 260 Ind. 249, 297 N.E.2d 425 (1973).

2. *Id.* at 253, 297 N.E.2d at 428.

3. IND. CODE §§ 22-3-1-10 to -10-3 (1988).

4. IND. CODE § 22-3-2-15 (1982) (emphasis added).

5. *Frampton*, 260 Ind. at 252, 297 N.E.2d at 428.



will employee brought an action in tort for retaliatory discharge following discharge on account of his exercising a personal, statutorily conferred right to file a workmen's compensation claim.

In 1986, the scope of the *Frampton* exception was tested before the supreme court in *Morgan Drive Away, Inc. v. Brant*.<sup>6</sup> In *Morgan Drive Away*, the court *refused* to extend its *Frampton* exception to include a claim of retaliatory discharge brought by plaintiff Brant, in which he alleged that he had been terminated in retaliation for having filed a small claims action against his employer. In refusing to extend its *Frampton* exception, the court noted that, since *Frampton* had been decided, Indiana courts had consistently refused to extend the at-will exception beyond those cases in which an employee had allegedly been discharged in retaliation for having filed a workmen's compensation claim.<sup>7</sup> The court concluded in *Morgan Drive Away* that, if its narrow *Frampton* exception were to be broadened, such revision was "better left to the legislature."<sup>8</sup>

Following *Morgan Drive Away*, there appeared to be a clear judicial policy in Indiana that, absent legislative action, the scope of Indiana's "public policy exception" to the at-will rule would be limited *solely* to cases in which an employee was alleging retaliatory discharge for having filed a workmen's compensation claim. However, despite *Morgan Drive Away*, this survey period has seen several court decisions which have further eroded the at-will rule in Indiana.

On August 5, 1987, the United States District Court for the Northern District of Indiana issued its decision in *Sarratore v. Longview Van Corp.*<sup>9</sup> In *Sarratore*, the plaintiff was an at-will employee who had been discharged after refusing to participate in his employer's unlawful scheme to set back vehicle odometers in violation of the federal Motor Vehicle Information and Cost Savings Act.<sup>10</sup> In determining the Indiana law to apply to this claim of retaliatory discharge, brought in federal court under diversity of citizenship jurisdiction, the federal district court examined the interplay of *Morgan Drive Away* with the Second District Court of Appeals of Indiana decision in *McClanahan v. Remington Freight Lines, Inc.*,<sup>11</sup> a case that was then pending review by the Indiana Supreme Court.<sup>12</sup>

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6. 489 N.E.2d 933 (Ind. 1986).

7. *Id.* at 934.

8. *Id.*

9. 666 F. Supp. 1257 (N.D. Ind. 1987).

10. *Id.* at 1258-59. See 15 U.S.C. §§ 1901-2012 (1982).

11. 498 N.E.2d 1336 (Ind. Ct. App. 1986), *aff'd in part*, 517 N.E.2d 390 (1988).

12. *Sarratore*, 666 F. Supp. at 1260.

*McClanahan* involved an interstate truck driver who had, in 1981, been hired by Remington Freight Lines as an at-will employee. In early 1982, McClanahan had been assigned to drive a truck weighing approximately 78,000 pounds from New York to Minnesota, via Illinois. At that time, Illinois law forbid trucks weighing over 75,000 pounds from traveling on its highways. When McClanahan informed Remington that his truck was too heavy to drive on Illinois roads, he was told to make the haul anyway, and that Remington would reimburse him for any overweight fines he incurred in driving through Illinois. When McClanahan continued to refuse to violate Illinois law and drive an overweight truck through Illinois, he was informed that his employment with Remington was terminated. McClanahan then brought suit against Remington for retaliatory discharge.<sup>13</sup>

In overturning the trial court's entry of summary judgment for Remington on McClanahan's claim of retaliatory discharge, the Indiana Court of Appeals rejected Remington's argument that the supreme court's *Frampton* decision, as clarified by *Morgan Drive Away*, limited Indiana's exception to the "at-will" rule *solely* to instances in which an employee had been discharged in retaliation for having filed a workmen's compensation claim.<sup>14</sup> In this regard, the court of appeals noted that:

While the Supreme Court's decision in *Morgan Drive Away* may indicate that not all statutorily conferred rights are entitled to the protection of the *Frampton* exception, we do not believe that the court meant to hold that an employee discharged for refusing to breach a statutorily imposed duty is to be left without redress. We simply cannot accept an interpretation of the *Morgan Drive Away* decision which would allow an employer to force an employee to choose between breaking the law and losing his job.<sup>15</sup>

The court of appeals then went on, in *dictum*, to establish factors it felt ought to be considered by Indiana courts in determining what statutorily-created rights, *in addition* to the filing of workmen's compensation claims, might also be subject to the *Frampton* exception to the "at-will" rule. In so doing, the court noted that:

Our Supreme Court clearly does not wish the *Frampton* door through the employment at will barrier opened so wide as to allow entry to every discharged and disgruntled employee. *Morgan Drive Away* makes clear that the statutorily conferred right

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13. *McClanahan*, 498 N.E.2d at 1336.

14. *Id.* at 1340-41.

15. *Id.* at 1340.



to wages will not give passage through the door, but the decision *does not state what, if any, other statutorily conferred rights will be unavailing. Such determinations must be made on a case by case basis, taking into account such factors as the legislative intent, whether the statute actually confers a right or merely a privilege, and the extent to which exercise of the statutorily conferred right interferes with the employee's performance of those duties which the employer may legally require of him.*<sup>16</sup>

In *Sarratore*, the federal district court quoted, with approval, the above portions of the Indiana Court of Appeal's reasoning in its *McClanahan* decision.<sup>17</sup> The district court then ruled that *Morgan Drive Away* did not, as a matter of Indiana law, prevent plaintiff Sarratore from maintaining an action in tort against his employer for retaliatory discharge.<sup>18</sup> The court specifically held that *Morgan Drive Away* did not limit the scope of an employee's claim under the *Frampton* exception "to situations where an employee files a workmen's compensation claim and is discharged in retaliation therefor."<sup>19</sup>

Subsequent to the federal district court's decision in *Sarratore*, the Indiana Supreme Court reviewed and upheld, in relevant part, the court of appeals decision in *McClanahan*.<sup>20</sup> In finding a second exception to the "at-will" rule in cases where an employee is discharged for refusing to violate a statutorily-conferred duty, the court held that: "[F]iring an employee for refusing to commit an illegal act for which he would be personally liable is as much a violation of public policy [as] declared by the legislature as firing an employee for filing a workmen's compensation claim."<sup>21</sup> However, while the court upheld the court of appeal's creation of a new exception to the "at-will" rule for employees discharged in retaliation for refusing to violate statutorily-conferred *duties*, the Court declined the lower court's implicit invitation in *McClanahan* to expand the *Frampton* exception to include statutorily-conferred *rights*, other than, and in addition to, the right to file a workmen's compensation claim.<sup>22</sup>

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16. *Id.* at 1341 (emphasis added).

17. *Sarratore*, 666 F. Supp. at 1262.

18. *Id.* at 1262-63.

19. *Id.* at 1263.

20. *McClanahan v. Remington-Freight Lines, Inc.*, 517 N.E.2d 390 (Ind. 1988).

21. *Id.* at 393.

22. *Id.* But see *Helman v. AMF, Inc.*, 675 F. Supp. 1163, 1164 (S.D. Ind. 1987), where the United States District Court for the Southern District of Indiana failed, in dicta, to limit Indiana's at-will exception to the statutorily-conferred *right to file a workmen's compensation claim*, stating that: "Indiana has, however, recognized an exception to the general [at-will] rule and that is for the tort of wrongful discharge in retaliation for exercising a statutory right or performing a statutory duty." *Id.* (emphasis added).

In *Wilmington v. Harvest Insurance Cos.*,<sup>23</sup> the First District Court of Appeals of Indiana rejected an argument that the *Frampton* exception to the "at-will" rule should be extended to include claims of retaliatory discharge by independent contractors.<sup>24</sup> In *Wilmington*, an insurance agent working as an independent contractor for an insurance company was discharged after he violated the terms of his exclusive agency contract by also selling insurance for another insurance company.<sup>25</sup> Citing *Frampton* and *McClanahan*, the plaintiff argued that, because Indiana Code section 27-4-3-2 generally permits insurance agents to sell insurance for more than one insurance company at a time, he had been wrongfully discharged for exercising this statutorily conferred right when he was terminated for violating the terms of his exclusive agency contract.<sup>26</sup>

The court of appeals was unpersuaded by the plaintiff's argument, noting that Indiana Code section 27-4-3-2 expressly *permitted* insurance agents to enter into exclusive agency contracts with insurance companies.<sup>27</sup> The court then went on to state, in *dictum*, that: "[T]he narrow exception [to the "at-will" rule] created in *Frampton* and extended in *McClanahan*, being humanitarian in purpose, did not apply to independent contractors . . . but applied to employees only. No Indiana case is cited which applies the exception beyond the narrow limits of *Frampton* and *McClanahan*."<sup>28</sup> The court of appeals affirmed the trial court's entry of summary judgment against the plaintiff on his cause of action for retaliatory discharge.

### B. Exceptions to the "At-Will" Rule Based in Contract

In addition to a judicial broadening of the *Frampton* exception to the Indiana "at-will" rule, the survey period also saw further judicial erosion of that rule through inroads made under the contract theory of law.

The first such inroad was made as a result of the supreme court's decision in *Romack v. Public Service Co.*<sup>29</sup> In *Romack*, the plaintiff had been employed by the Indiana State Police for 25 years at the time he was recruited by Public Service Company of Indiana (PSI) to fill an open security supervisor job position.<sup>30</sup> In responding to PSI's job offer, Romack told PSI that he had "permanent employment" with the Indiana

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23. 521 N.E.2d 953 (Ind. Ct. App. 1988).

24. *Id.* at 956.

25. *Id.* at 954.

26. *Id.* at 955-56.

27. *Id.* at 956.

28. *Id.*

29. 499 N.E.2d 768 (Ind. Ct. App. 1986), *aff'd in part*, 511 N.E.2d 1024 (1987).

30. *Romack*, 511 N.E.2d at 1025.



State Police and that he would not consider leaving that job unless PSI offered him the same job "permanency." After PSI gave Romack an oral assurance of similar job "permanency," he quit his job with the State Police and began working for PSI.<sup>31</sup> Approximately three years later, Romack was discharged from employment by PSI. He then filed suit against PSI, claiming, in part, that his discharge was wrongful because PSI's oral promise of "permanent employment" had changed his status from that of an "at-will" employee to that of an employee who was only subject to discharge for "good cause."<sup>32</sup>

In affirming the trial court's entry of summary judgment against Romack, the Fourth District Court of Appeals of Indiana stated that, under current Indiana law, an employment relationship was "at-will" unless there existed "a promise of employment for a fixed duration or the employee has given independent consideration beyond his services in exchange for the employment."<sup>33</sup> The court went on to state, however, that an "at-will" employment relationship in Indiana could be "converted to one requiring good cause before termination if the employee, in exchange for permanent employment, provides independent consideration that results in a detriment to him and a corresponding benefit to the employer."<sup>34</sup>

The appellate court then applied the Indiana "at-will" rule to the facts surrounding Romack's termination, and concluded that PSI's oral assurances of "permanent employment" did not establish for Romack a fixed duration of employment.<sup>35</sup> The court also concluded that Romack had not provided PSI with any significant independent consideration, beyond his services, in exchange for his employment.<sup>36</sup> Based on these findings, the court ruled that summary judgment for PSI on Romack's wrongful discharge claim was appropriate, as he had been an employee terminable "at-will" under Indiana law during his period of employment with PSI.<sup>37</sup>

In a vigorous dissent to the majority opinion, Judge Conover asserted that the facts surrounding Romack's discharge created an issue of substantial public importance which required a *change* in current Indiana case law and a denial of PSI's motion for summary judgment.<sup>38</sup> In Judge Conover's opinion, the factors which distinguished Romack's case from earlier Indiana "at-will" rule cases were that:

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31. *Id.*

32. *Id.*

33. *Romack*, 499 N.E.2d at 772.

34. *Id.*

35. *Id.* at 773.

36. *Id.*

37. *Id.* at 776.

38. *Id.* at 776-78 (Conover, J., dissenting).

1. Romack had 25 years of training with the Indiana State Police that "uniquely qualified" him for the PSI job position;

2. He had "lifetime employment" with the Indiana State Police;

3. He was "recruited" by PSI to fill a job position that required a person with his unique skills and abilities;

4. He had advised PSI that he would leave his State Police job only if his new job with PSI offered the same "permanency of employment;" and,

5. PSI had assured him that he would have "permanent employment" if he came to work for PSI.<sup>39</sup>

Judge Conover argued that these factors established "independent consideration" of sufficient detriment to elevate Romack from the status of an "at-will" employee to that of an employee terminable only for "good cause" under Indiana law.

Judge Conover went on to state that, after reviewing decisions from other jurisdictions on the issue of whether an employee who gave up "permanent" employment to accept a "permanent" job offer by a new employer had provided "independent consideration," he had concluded that: "[A]n employer cannot arbitrarily fire an employee when (1) the employer knows the employee had a former job with assured permanency (or assured nonarbitrary firing policies) and (2) was only accepting the new job upon receiving assurances the new employer could guarantee similar permanency."<sup>40</sup> Judge Conover then concluded that Romack had provided sufficient independent consideration to PSI to have obtained the status of an employee dischargeable only for "good cause," that Romack had not been discharged by PSI for "good cause," and that PSI's motion for summary judgment as to Romack's wrongful discharge claim should have therefore been denied.<sup>41</sup>

On appeal, the Indiana Supreme Court adopted and incorporated by reference Judge Conover's dissenting opinion in *Romack* as it applied to Romack's breach of employment contract claim, and reversed the trial court's entry of summary judgment for PSI on that issue.<sup>42</sup>

Shortly after the Indiana Supreme Court issued its decision in *Romack*, that decision was interpreted and, at least in *dictum*, further broadened by the Third District Court of Appeals of Indiana in *Whiteco Industries, Inc. v. Kopani*.<sup>43</sup> In *Whiteco*, an employee named Richard Kordos was hired into the "executive producer" job position and assigned to run Whiteco's theatre operations. In recruiting Kordos, Whiteco had ap-

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39. *Id.* at 776-77.

40. *Id.* at 778.

41. *Id.* at 778, 780.

42. *Romack v. Public Serv. Co.*, 511 N.E.2d 1024 (Ind. 1987).

43. 514 N.E.2d 840 (Ind. Ct. App. 1987).



parently promised him the executive producer job position for an entire year. In accepting Whiteco's employment offer, Kordos gave up his current job, and came to Whiteco already possessing the qualifications necessary to work in the executive producer job position.<sup>44</sup>

Appealing the trial court's grant of judgment on the evidence for Whiteco, Kordos argued that the facts present in his case were sufficiently similar to those found in *Romack* so as to make the trial court's granting of judgment on the evidence against him in error.<sup>45</sup> The court of appeals disagreed, concluding that neither the job Kordos forfeited nor the one-year assurance of employment Whiteco had promised him sufficiently paralleled the "permanent" employment forfeited by and promised to the employee in *Romack*, so as to elevate Kordos to the status of an employee dischargeable only for "good cause" under the *Romack* exception to Indiana's at-will employment rule.<sup>46</sup> However, in reaching its conclusions, the court of appeals went on to interpret *Romack*, in *dictum*, as *not necessarily* being limited to cases in which an employee had been promised "permanent employment" or had given up "permanent employment." The court stated that *Romack* could also be applied to promised employment for "a term of years,"<sup>47</sup> or to employment given up which had "provided unique features of tenure [or] retirement rights . . . to which the employee was then entitled."<sup>48</sup> After so interpreting *Romack*, the court of appeals upheld the trial court's judgment on the evidence against Kordos.

In *Shannon v. Bepko*,<sup>49</sup> the United States District Court for the Southern District of Indiana may have created yet another exception to the "at-will" rule in instances where an "implied contract of continued employment" can be found to exist based on the "common law" of a particular industry or plant. In *Bepko*, Indiana University-Purdue University at Indianapolis (IUPUI) hired the plaintiff, Shannon, as an "at-will" employee for an indefinite term of employment. Twelve years later, IUPUI summarily terminated Shannon for allegedly falsifying his time sheet.<sup>50</sup> In response, Shannon brought suit in federal district court alleging that he had a protectable interest in his continued employment with IUPUI and that his discharge without any form of predeprivation hearing violated his procedural due process rights under the Fourteenth Amendment to the United States Constitution.<sup>51</sup> Shannon claimed that the

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44. *Id.* at 842-43.

45. *Id.* at 846.

46. *Id.*

47. *Id.*

48. *Id.*

49. 684 F. Supp. 1465 (S.D. Ind. 1988).

50. *Id.* at 1467-68.

51. *Id.* at 1468.

protectable property interest he had in his continued employment with IUPUI was created by the "rules and understandings" contained in his employee handbook. The district court rejected this contention, stating that Indiana courts "have been unequivocal in their rejection of alleged property rights based on employee handbooks."<sup>52</sup>

However, the district court then went on to find that, *despite* the absence of an express employee contract between Shannon and IUPUI *and* the fact that Shannon's employee handbook did not create an implied employment contract under Indiana law, there might *still* exist an "implied contract" which gave Shannon a property interest in his job.<sup>53</sup> In support of this ruling, the district court quoted the United States Supreme Court's declaration in *Perry v. Sindermann*<sup>54</sup> that:

Just as this Court has found there to be a "common law of a particular industry or a particular plant" that may supplement a collective-bargaining agreement, *Steelworkers v. Warrior & Gulf Co.*, 363 U.S. 574, 579, *so there may be an unwritten "common law" in a particular university that certain employees shall have the equivalent of tenure.*<sup>55</sup>

As the parties in *Bepko* had not addressed this "common law" theory of property interest in their arguments to the court, the district court refused to grant summary judgment for IUPUI on that issue.<sup>56</sup>

### III. EXCLUSIVITY OF REMEDY UNDER WORKMEN'S COMPENSATION ACT AS BAR TO EMPLOYEE ACTIONS IN TORT

Indiana courts have long held that the rights and remedies afforded employees by the Indiana Workmen's Compensation Act should extend to *all* situations in which an injured employee would have had a remedy at common law were it not for the Act.<sup>57</sup> Such reasoning has been based on the Act's "exclusivity of remedy" provision, Indiana Code section 22-3-2-6, which provides that:

*The rights and remedies herein granted to an employee subject to this Act on account of personal injury or death by accident shall exclude all other rights and remedies of such employee,*

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52. *Id.* at 1478.

53. *Id.* at 1479.

54. 408 U.S. 593 (1972).

55. *Id.* at 602 (emphasis added).

56. *Bepko*, 684 F. Supp. at 1479.

57. See *Burkhart v. Wells Electronics Corp.*, 139 Ind. App. 658, 662, 215 N.E.2d 879, 881 (1966), (quoting *In re Bowers*, 65 Ind. App. 128, 132, 116 N.E.2d 842 (1917)).



his personal representatives, dependents or next of kin, at common-law or otherwise, *on account of such injury or death*.<sup>58</sup>

In 1986, the Indiana Supreme Court, in *Evans v. Yankeetown Dock Corp.*,<sup>59</sup> expressly interpreted the "exclusivity provision" of the Indiana Workmen's Compensation Act as excluding:

[A]ll rights and remedies of an employee against his employer for personal injury or death if the following three statutory jurisdictional prerequisites are met:

- A. personal injury or death *by accident*;
- B. personal injury or death *arising out of employment*;
- C. personal injury or death *arising in the course of employment*.<sup>60</sup>

During the survey period, Indiana courts generally continued to interpret the scope of the Act's "exclusivity provision" very broadly, holding that injuries with arguably tenuous causal connections to an employment relationship were nonetheless compensable only under the Act.

In *Consolidated Products, Inc. v. Lawrence*,<sup>61</sup> an employee was injured after she had remained on her employer's premises past the end of her work shift in order to purchase a milk shake, and then had been abducted and assaulted in the employer's parking lot while waiting for a ride home from work. The employee subsequently brought and prevailed in a suit in tort against her employer for negligence.<sup>62</sup> On appeal by the employer from the trial court's denial of its motion for summary judgment, the Second District Court of Appeals of Indiana followed the jurisdictional prerequisites set forth by the Indiana Supreme Court in *Yankeetown Dock*, and concluded that the employee's injuries were compensable solely under the Workmen's Compensation Act.<sup>63</sup> The court thus reversed the trial court's denial of the employer's motion for summary judgment as to the employee's personal injury action for negligence. In reaching its decision, the court of appeals held that the employer had met the first *Yankeetown Dock* prerequisite by showing that the employee's injury was "unexpected" and had thus occurred "by accident."<sup>64</sup> The court held that the second *Yankeetown Dock* prerequisite had been met because the employee, in agreeing to work

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58. IND. CODE § 22-3-2-6 (1988) (emphasis added).

59. 491 N.E.2d 969 (Ind. 1986).

60. *Id.* at 973 (emphasis added).

61. 521 N.E.2d 1327 (Ind. Ct. App. 1988).

62. *Id.* at 1328.

63. *Id.* at 1331.

64. *Id.* at 1329.

nights for an employer whose establishment was located in an unsafe area, increased her risk of harm and made that risk "incident to" her late night employment.<sup>65</sup> Therefore, the court reasoned that the employee's injuries "arose out of" her employment because they were causally related to her employment.<sup>66</sup> The third *Yankeetown Dock* prerequisite had been met, in the court's opinion, because the employee's injuries occurred in the employer's parking lot as the employee was leaving work. The court rejected the employee's argument that her stop for a milk shake served to "remove" her from her "employee status" and caused her injuries to arise outside the course of her employment.<sup>67</sup>

In *K-Mart Corp. v. Novak*,<sup>68</sup> the First District Court of Appeals of Indiana rejected an employer's argument that an "increased risk" analysis had to be used by the court in determining whether an employee's injuries "arose out of" his employment. In *Novak*, K-Mart employee Margaret Novak was shot to death by a lunatic. At the time she was shot, Novak was working at her station inside her employer's store.<sup>69</sup> K-Mart appealed the Industrial Board's initial grant of workmen's compensation death benefits to Novak's widower, claiming that her death did not "arise out of" her employment with K-Mart.<sup>70</sup> K-Mart argued that the court of appeals was required to use an "increased risk" analysis in determining whether Novak's death "arose out of" her employment. Under such an "increased risk" analysis, K-Mart asserted that the court could not find that Novak's death "arose out of" her employment, so as to be covered by the Indiana Workmen's Compensation Act, unless there was proof of an "increased risk" to Novak as a result of her employment by K-Mart.<sup>71</sup>

The court of appeals rejected K-Mart's argument that an "increased risk" analysis was required under Indiana law in order to find that an employee's injury "arose out of" employment, stating that the policy of the Workmen's Compensation Act favored "a liberal construction" that would also grant compensation to employees in cases involving "neutral risks."<sup>72</sup>

The court of appeals then concluded that Novak was at her work station because of her employment; that absent her employment she would not have been subjected to a risk of death by the lunatic; and

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65. *Id.*

66. *Id.*

67. *Id.* at 1330.

68. 521 N.E.2d 1346 (Ind. Ct. App. 1988).

69. *Id.* at 1347.

70. *Id.*

71. *Id.* at 1349-50.

72. *Id.* at 1350.



that, therefore, her risk of death was causally connected to and an incident of her employment with K-Mart.<sup>73</sup> Based on this reasoning, the court found that the Industrial Board had not erred in finding that Novak's death "arose out of" her employment with K-Mart and that her death was compensable under the Indiana Workmen's Compensation Act.

In *National Can Corp. v. Jovanovich*,<sup>74</sup> an employee injured in the workplace was successful in *avoiding* the summary dismissal of his claim against his employer in tort for intentional injury, despite the "exclusivity provision" of the Indiana Workmen's Compensation Act. In *National Can*, employee Jovanovich claimed that his previous back injury had been aggravated by his employer's refusal to assign him light duties, after receiving a note from Jovanovich's doctor requesting that he be temporarily assigned such work.<sup>75</sup> Jovanovich argued before the LaPorte Superior Court that, under these circumstances, National Can had acted out of malice in intentionally refusing to assign him such work, and had, therefore, *intentionally* injured him. The trial court agreed with Jovanovich, and awarded him compensatory and punitive damages.<sup>76</sup>

On appeal to the Third District Court of Appeals, National Can argued, in part, that Jovanovich's claim of intentional injury was barred by the "exclusivity provision" of the Indiana Workmen's Compensation Act. Jovanovich responded by claiming that, while his back injury "arose out of" his employment with National Can, the injury fell *outside* the jurisdiction of the Workmen's Compensation Act because Jovanovich had "anticipated" the injury and therefore it could not have occurred "by accident."<sup>77</sup>

The court of appeals rejected Jovanovich's argument, stating that even in instances where an employee "expects or anticipates an injury," that injury may nevertheless arise "by accident" within the meaning of the Act.<sup>78</sup> However, the court of appeals then went on to note that:

[B]oth the plain language of the compensation statute and the opinion in *Yankeetown* recognize that if an employer intentionally injures an employee, the Act does not apply.

Public policy reinforces this conclusion since it would be a total perversion of the humanitarian purposes of the Act to permit an employer to use the Act as a shelter against liability for an intentional tort.

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73. *Id.*

74. 503 N.E.2d 1224 (Ind. Ct. App. 1987).

75. *Id.* at 1225-26.

76. *Id.* at 1227.

77. *Id.* at 1232.

78. *Id.*

Thus, the trial court had jurisdiction to entertain Jovanovich's claim alleging an intentional tort.<sup>79</sup>

Having thus found an exception to the "exclusivity provision" of the Indiana Workmen's Compensation Act in cases where an employer *intentionally* injures an employee, the court of appeals went on to find that Jovanovich's intentional injury claim failed, as a matter of law, because there was no proof of the required "specific intent" element of this claim brought outside the scope of the Act.<sup>80</sup> The court of appeals reversed the trial court's judgment in favor of Jovanovich.

#### IV. SUMMARY

The survey period saw three significant developments in Indiana employment law. First, both the federal district court's decision in *Sarratore v. Longview Van Corp.*<sup>81</sup> and the Indiana Supreme Court's decision in *McClanahan v. Remington Freight Lines, Inc.*<sup>82</sup> eroded further the "at-will" rule in Indiana, by recognizing employee actions in tort for retaliatory discharge based on refusals to violate *any* statutorily-imposed *duty*. However, the Supreme Court's refusal in *McClanahan* to include statutorily-conferred *rights*, other than the right to file a workmen's compensation claim, within its *Frampton*<sup>83</sup> exception apparently signifies that an "at-will" employee in Indiana is not protected from discharge based on his exercise of such rights. The Third District Court of Appeals, in *Wilmington v. Harvest Insurance Cos.*,<sup>84</sup> also refused to broaden the scope of the *Frampton* exception to include claims of wrongful discharge brought by independent contractors.

Second, the Indiana Supreme Court created a separate and distinct exception to the "at-will" rule in its *Romack v. Public Service Co.*<sup>85</sup> decision. In *Romack*, the court held that an employee's abandonment of "permanent employment" in reliance on a new employer's assurances of similar "permanent employment" constitutes sufficient independent consideration to convert the employee from the status of an "at-will" employee to that of an employee who can be discharged only for "good cause." In *Whiteco Industries, Inc. v. Kopani*,<sup>86</sup> the Third District Court of Appeals, in *dictum*, broadened the Supreme Court's *Romack* decision

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79. *Id.*

80. *Id.* at 1234.

81. 666 F. Supp. 1257 (N.D. Ind. 1987).

82. 498 N.E.2d 1336 (Ind. Ct. App. 1986), *aff'd in part*, 517 N.E.2d 390 (1988).

83. *Frampton v. Central Indiana Gas Co.*, 260 Ind. 249, 297 N.E.2d 425 (1973).

84. 521 N.E.2d 953 (Ind. Ct. App. 1988).

85. 499 N.E.2d 768 (Ind. Ct. App. 1986), *aff'd in part*, 511 N.E.2d 1024 (1987).

86. 514 N.E.2d 840 (Ind. Ct. App. 1987).



to include, within the potential group of employees eligible for elevation from an "at-will" to a "good cause" status as a matter of law, those employees who are promised employment for a "term of years" and who thereafter abandon previous employment that had provided them with unique tenure or retirement rights. Furthermore, in *Shannon v. Bepko*,<sup>87</sup> the federal District Court may have created another exception to the Indiana "at-will" rule in cases where an employee is able to show that he has an "implied contract of employment" on the basis of the "common law" present in his place of work.

Third, Indiana courts have continued to interpret the Indiana Workmen's Compensation Act broadly so as to encompass any injuries arguably arising out of an employee's employment, as shown by the recent court of appeals decision in *Consolidated Products, Inc. v. Lawrence*.<sup>88</sup> Furthermore, in *K-Mart v. Novak*,<sup>89</sup> the First District Court of Appeals rejected the notion that an employee's "risk of injury" must have been increased as a result of employment in order for such employee's workplace injury to "arise out of" employment and be subject to the "exclusivity provision" of the Act. Finally, the Third District Court of Appeals ruled, in *National Can Corporation v. Jovanovich*,<sup>90</sup> that injuries to an employee which are intentionally caused by his employer fall outside the scope of the Act's "exclusivity provision" and can be remedied through a private action for damages based in tort.

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87. 684 F. Supp. 1465 (S.D. Ind. 1988).

88. 521 N.E.2d 1327 (Ind. Ct. App. 1988).

89. 521 N.E.2d 1346 (Ind. Ct. App. 1988).

90. 503 N.E.2d 1224 (Ind. Ct. App. 1987).

# Survey of Indiana Products Liability Cases: 1987-88

MICHAEL ROSIELLO\*

RONALD V. WEISENBERGER\*\*

## I. INTRODUCTION

This Article surveys state and federal cases that affected or discussed Indiana's products liability tort law. Although the authors were not bound to a particular survey period, the cases included in this article were decided during the period between June 1987 and August 1988. The Article discusses Indiana Supreme Court<sup>1</sup> and Indiana Court of Appeals<sup>2</sup> decisions as well as Seventh Circuit Court of Appeals<sup>3</sup> and federal district court<sup>4</sup> cases that have applied Indiana law. In addition, the Article discusses a recent United States Supreme Court case that will affect Indiana products liability law.<sup>5</sup>

## II. THE CASES

### A. *A New Choice of Law Rule*

In *Hubbard Manufacturing Co. v. Greeson*,<sup>6</sup> the Supreme Court of Indiana overruled one hundred years of precedent and adopted a two-

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\* Partner, Barnes & Thornburg, Indianapolis. A.B., Economics, Columbia University, 1973; J.D., Stanford University Law School, 1976.

\*\* Associate, Barnes & Thornburg, Indianapolis. A.B., English Literature, University of Notre Dame, 1970; J.D. (magna cum laude), Indiana University School of Law—Indianapolis, 1988.

Ronald V. Weisenberger passed away suddenly on March 25, 1989. From working with Ron, I knew his intelligence, his good humor, and his zest for the challenges of litigation. His large contribution to this Article is only one example of Ron's ability and capacity for hard work. The Indiana bar will be poorer because Ron was deprived of the opportunity to pursue his profession.—Michael Rosiello

1. *Hinkle v. Niehaus Lumber Co.*, 535 N.E.2d 1243 (Ind. 1988); *Hubbard Mfg. Co. v. Greeson*, 515 N.E.2d 1071 (Ind. 1987).

2. *Koske v. Townsend Eng'g Co.*, 526 N.E.2d 985 (Ind. Ct. App. 1988); *Miller v. Todd*, 518 N.E.2d 1124 (Ind. Ct. App. 1988); *Kroger Co. Sav-On Store v. Presnell*, 515 N.E.2d 538 (Ind. Ct. App. 1987); *Wixom v. Gledhill Road Mach. Co.*, 514 N.E.2d 306 (Ind. Ct. App. 1987); *Hinkle v. Niehaus Lumber Co.*, 510 N.E.2d 198 (Ind. Ct. App. 1987), *vacated* 525 N.E.2d 1243 (Ind. 1988).

3. *Hager v. National Union Elec. Co.*, 854 F.2d 259 (7th Cir. 1988); *Phelps v. Sherwood Medical Indus.*, 836 F.2d 296 (7th Cir. 1987).

4. *Knox v. AC & S, Inc.*, 690 F. Supp. 752 (S.D. Ind. 1988); *Reed v. Ford Motor Co.*, 679 F. Supp. 873 (S.D. Ind. 1988); *Covalt v. Carey-Canada, Inc.*, 672 F. Supp. 367 (S.D. Ind. 1987); *McDowell v. Johns-Manville Sales Corp.*, 662 F. Supp. 934 (S.D. Ind. 1987); *Groce v. Johns-Manville Sales Corp.*, 662 F. Supp. 936 (S.D. Ind. 1987).

5. *Boyle v. United Technologies Corp.*, 108 S. Ct. 2510 (1988).

6. 515 N.E.2d 1071 (Ind. 1987).



step choice of law rule for products liability and other tort actions that permits trial courts to apply Indiana law even if the place of injury is another state. As the court itself noted, this new rule is not merely academic; the differences between Indiana's substantive products liability law and that of some other states "are important enough to affect the outcome of the litigation."<sup>7</sup>

1. *Background.*—"The traditional rule in conflict of law cases involving multistate torts has been to apply the substantive law of the place of tort—the *lex loci delicti* rule."<sup>8</sup> The place of the tort is "the state where the last event necessary to make an actor liable for the alleged wrong takes place."<sup>9</sup> Generally, this is the place where the injury or death occurs. Proponents of the rule claimed that the rule "promote[s] certainty, predictability, uniformity of result, and [is] easy to apply."<sup>10</sup> Others thought that it was too mechanical and often led to unjust results.<sup>11</sup> In *Babcock v. Jackson*,<sup>12</sup> the Court of Appeals of New York adopted what has been called the "modern" or the "most significant relationship" rule:

Justice, fairness and "the best practical result" may best be achieved by giving controlling effect to the law of the jurisdiction which, because of its relationship or contact with the occurrence or the parties, has the greatest concern with the specific issue raised in the litigation. The merit of such a rule is that "it gives to the place 'having the most interest in the problem' paramount control over the legal issues arising out of a particular factual context" and thereby allows the forum to apply "the policy of the jurisdiction 'most intimately concerned with the outcome of [the] particular litigation.'"<sup>13</sup>

For years Indiana has applied the *lex loci* rule.<sup>14</sup> In *Witherspoon v. Salm*,<sup>15</sup> the Indiana Court of Appeals attempted to reject the rule: "We believe the more logical basis for a choice of conflicting law, could be stated: *Given a factual and legal situation, involving an actual conflict*

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7. *Id.* at 1073.

8. *Maroon v. Department of Mental Health*, 411 N.E.2d 404, 417 (Ind. Ct. App. 1980) (Ratliff, J., concurring).

9. *Greeson*, 515 N.E.2d at 1073.

10. *Maroon*, 411 N.E.2d at 418 (Ratliff, J., concurring).

11. *Id.*

12. 12 N.Y.2d 473, 191 N.E.2d 279, 240 N.Y.S.2d 743 (1963).

13. *Id.* at 481-82, 191 N.E.2d at 283, 240 N.Y.S.2d at 749, (citations omitted).

14. See cases cited in *Hubbard Mfg. Co. v. Greeson*, 487 N.E.2d 825, 827 (Ind. Ct. App. 1986), *vacated*, 515 N.E.2d 1071 (Ind. 1987).

15. 142 Ind. App. 655, 237 N.E.2d 116 (1968), *rev'd*, 251 Ind. 575, 243 N.E.2d 876 (1969).

of law, which state has the greater interest in having its law applied?"<sup>16</sup> The Indiana Supreme Court reversed the appellate court's opinion<sup>17</sup> and found no conflict of law issue in the case.<sup>18</sup> A number of federal court decisions, applying Indiana law, had concluded that the Indiana Supreme Court would adopt the modern, most significant relationship rule.<sup>19</sup>

2. *The Greeson Case*.—In *Greeson*, plaintiff's decedent, an Indiana resident, was an employee of a company that cleaned, repaired and replaced streetlights. The defendant, an Indiana corporation, built custom lift units for the employer and attached them to the employer's trucks. The decedent was killed while he was working on street lights in Illinois and while using a lift unit that defendant had manufactured and that was licensed and housed in Illinois.<sup>20</sup>

Plaintiff filed a wrongful death action in Indiana in which she sought to recover under negligence and strict liability theories. On the choice of law issue, "[t]he trial court found that Indiana had more significant contacts with the litigation but felt constrained to apply Illinois substantive law because the decedent's injury had been sustained there."<sup>21</sup> The court of appeals affirmed on the ground that this result was required by Indiana law:

Although many states have adopted a more flexible modern choice of law approach in these cases, Indiana has not. As the trial court properly concluded, for suits based on tort principles, the applicable choice of law rule in Indiana remains *lex loci delicti*. In this case, [decedent] was killed in Illinois. Therefore, Illinois will control all substantive issues which arise during the trial of this cause.<sup>22</sup>

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16. *Id.* at 670, 237 N.E.2d at 124.

17. 251 Ind. 575, 243 N.E.2d 876 (1969).

18. *Id.* at 580, 243 N.E.2d at 878.

19. See *Gianni v. Fort Wayne Air Serv., Inc.*, 342 F.2d 621 (7th Cir. 1965); *Watts v. Pioneer Corn Co.*, 342 F.2d 617 (7th Cir. 1965). But see *Bowen v. United States*, 570 F.2d 1311, 1319 n.18 (7th Cir. 1978) (stating that Indiana apparently follows the *lex loci* rule).

20. 515 N.E.2d 1071, 1072 (Ind. 1987).

21. *Id.*

22. *Hubbard Mfg. Co. v. Greeson*, 487 N.E.2d 825, 827 (Ind. Ct. App. 1986), *vacated*, 515 N.E.2d 1071 (Ind. 1987) (footnotes and citations omitted). Judge Ratliff, writing for the court of appeals, made clear his disagreement with the controlling authority:

This writer continues to adhere to his belief . . . that the better rule in these cases is the so-called "modern rule" or "most significant relationship approach" . . . . Given the opportunity, our supreme court may likewise adopt the "most significant relationship approach." However, until it does so, this court is bound to apply those legal principles announced by the highest court of this state including the doctrine of *lex loci delicti*.

*Hubbard*, 487 N.E.2d at 827 n.1.



The supreme court reversed and adopted a two-step choice of law rule for tort claims. "The first step . . . is to consider whether the place of the tort 'bears little connection' to th[e] legal action."<sup>23</sup> If it is "determined that the place of the tort bears little connection to the legal action, the second step is to apply the additional factors."<sup>24</sup> The additional factors, which "should be evaluated according to their relative importance to the particular issues being litigated,"<sup>25</sup> are those listed in the Restatement (Second) of Conflict of Laws.<sup>26</sup> They include: "1) the place where the conduct causing the injury occurred; 2) the residence or place of business of the parties; and 3) the place where the relationship is centered."<sup>27</sup> The *Greeson* court applied the new analytical framework as follows:

[Step 1:] The last event necessary to make [defendant] liable for the alleged tort took place in Illinois. The decedent was working in Illinois at the time of his death and the vehicle involved in the fatal injuries was in Illinois. The coroner's inquest was held in Illinois, and the decedent's wife and son are receiving benefits under the Illinois Workmen's Compensation Laws. None of these facts relates to the wrongful death action filed against [defendant]. The place of the tort is insignificant to this suit. . . .

[Step 2:] Indiana has the more significant relationship and contacts. The plaintiff's two theories of recovery relate to the manufacture of the lift in Indiana. Both parties are from Indiana; plaintiff Elizabeth Greeson is a resident of Indiana and defendant Hubbard is an Indiana corporation with its principal place of business in Indiana. The relationship between the deceased and Hubbard centered in Indiana. The deceased frequently visited defendant's plant in Indiana to discuss the repair and maintenance of the lift. Indiana law applies.<sup>28</sup>

Although *Greeson* plainly announced a change in Indiana conflict of law doctrine, it is unclear whether (a) Indiana has abandoned *lex loci delicti* for the modern "most significant contacts" rule, or (b) Indiana has retained *lex loci delicti* but adopted an exception under which the "additional factors" can be considered in some cases. In *Hager v. National Union Electric Co.*,<sup>29</sup> the Seventh Circuit took the latter position.

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23. 515 N.E.2d at 1074.

24. *Id.*

25. *Id.*

26. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145 (1971).

27. 515 N.E.2d at 1073-74 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145(2) (1971)).

28. *Id.* at 1074.

29. 854 F.2d 259 (7th Cir. 1988).

There, addressing the choice of law issue in a retaliatory discharge case, the court stated that *Greeson* “adhered to the language contained in section 377 of the original Restatement of Conflicts,”<sup>30</sup> but “the [*Greeson*] court also created a ‘safety valve’ for those cases where the application of the basic rule would lead to application of the law of a state that would have little connection with the underlying cause of action. . . .”<sup>31</sup>

The authors of this Article disagree and believe that *Greeson* in essence adopted the modern choice of law rule as set forth in the Restatement (Second) of Conflict of Laws.<sup>32</sup> In most personal injury actions, “the last event necessary to make an actor liable for the alleged wrong” determines the place of injury. Under the *lex loci delicti* rule, the substantive law of the place where the injury occurs governs, but the *Greeson* court held that the place of injury alone cannot be used to determine the controlling law.<sup>33</sup> Consequently, after *Greeson* there is little or nothing left of the *lex loci* rule as such, and the “additional factors” will have to be considered in virtually every case. Furthermore, modern authorities retain a preference for the law of the state where the injury occurred,<sup>34</sup> which is consistent with the two-step analysis of the *Greeson* opinion.<sup>35</sup> Finally, if *Greeson* is read as embracing the

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30. *Id.* at 262. “The place of the wrong is the state where the last event necessary to make an actor liable for an alleged tort takes place.” RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 377 (1934). This definition was then used to state the general principles of *lex loci delicti*. *Id.*, §§ 378-97.

31. 854 F.2d at 262.

32. The Restatement (Second) of Conflict of Laws provides:

(1) The rights and liabilities of the parties with respect to an issue in tort are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the occurrence and the parties under the principles stated in § 6.

(2) Contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

(a) the place where the injury occurred,

(b) the place where the conduct causing the injury occurred,

(c) the domicil, residence, nationality, place of incorporation and place of business of the parties, and

(d) the place where the relationship, if any, between the parties is centered.

These contacts are to be evaluated according to their relative importance with respect to the particular issue.

RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145 (1971).

33. *Greeson*, 515 N.E.2d at 1074.

34. “In an action for a personal injury, the local law of the state where the injury occurred determines the rights and liabilities of the parties, unless, with respect to the particular issue, some other state has a more significant relationship . . . to the occurrence and the parties. . . .” RESTATEMENT (SECOND) OF THE CONFLICT OF LAWS § 146 (1971). See also *id.* §§ 156-174 (stating choice of law rules for particular tort issues).

35. See *id.* § 146 comment c.



modern choice of law rules for torts, the extensive authorities and analysis under those rules will be available to assist Indiana courts and attorneys. This will promote the choice of law values of "certainty, predictability, and uniformity of result. . . ."<sup>36</sup>

### *B. Warnings and Instructions*

*1. Duty to Warn About Dangers Associated with Unforeseeable Uses.*—In *Hinkle v. Niehaus Lumber Co.*,<sup>37</sup> the Indiana Supreme Court held that a supplier has no duty to warn a purchaser about dangers unknown to the purchaser unless "the supplier knew or had reason to know that the product was likely to be dangerous when used in a foreseeable manner."<sup>38</sup>

In *Hinkle*, plaintiff's employer, Alumax, wanted to replace the roof over a shed in which the employer stored corrosive materials. A contractor submitted a bid to replace the roof with fiberglass, a material that does not corrode. The employer rejected the bid because it wanted to do the job more cheaply. Instead, the employer decided to furnish the roofing material and to hire the contractor to provide the labor to install it. Even though the employer's maintenance supervisor told the employer that sheet metal would be more expensive in the long run because it would deteriorate faster than fiberglass, the employer purchased twenty-eight gauge sheet metal roofing from the defendant, Niehaus. A heavier gauge sheet metal would have been more suitable for the job, but the roofing material would support a man's weight under normal use. Apparently, the employer thought that the roof would be stronger if the sheet metal was installed so that there was an eighteen-inch overlap. In fact, this causes the roof to corrode more rapidly.<sup>39</sup>

The employer decided to use the twenty-eight gauge sheet metal and to overlap it without consulting the supplier, who simply provided the material requested by the employer. The supplier did not know how the employer intended to use the sheet metal roofing. The supplier provided no warnings or instructions with the sheet metal roofing. Six months after the roof was installed, the employer ordered the plaintiff to repair the roof. While the plaintiff was walking on the roof, it collapsed because of excessive corrosion, and plaintiff was injured severely.<sup>40</sup>

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36. *Maroon v. Department of Mental Health*, 411 N.E.2d 404, 418 (Ind. Ct. App. 1980) (Ratliff, J., concurring).

37. 525 N.E.2d 1243 (Ind. 1988).

38. *Id.* at 1245.

39. *Id.* at 1244.

40. *Id.*

The trial court granted the supplier's motion for summary judgment, and the court of appeals reversed.<sup>41</sup> According to the court of appeals, the issue was whether the supplier had a duty to warn the employer that the sheet metal would corrode and weaken in the corrosive environment, that it would corrode more rapidly when overlapped excessively, and that it was too thin to support a man's weight without additional support.<sup>42</sup>

The answer turns upon whether Alumax as a purchaser having common understanding knew or should have known of these dangerous propensities at the time it purchased this roofing material, or whether any one or all such propensities were unreasonable dangers known to Alumax at that time. If Alumax because of its common understanding knew or should have known of all of these propensities, no duty to warn or instruct arose. If, on the other hand, any one or more of these propensities were unreasonable dangers unknown to Alumax, a duty to warn or instruct Alumax at the time of sale arose as to Niehaus.<sup>43</sup>

The court of appeals held that the record was insufficient to determine what the employer, as purchaser, knew or should have known about the dangers to the plaintiff and, therefore, summary judgment was improper.<sup>44</sup>

The supreme court disagreed and stated that "the extent of a purchaser's knowledge is not the sole criteria giving rise to a duty to warn."<sup>45</sup> The supreme court affirmed summary judgment for defendant because plaintiff "presented no evidence to show that [defendant] knew or should have had any reasonable expectation that the metal roofing sheets were to be used in an unusually corrosive environment,"<sup>46</sup> and because there was "no evidence in the record that the roofing sheets were unreasonably dangerous when used in 'reasonably expectable handling and consumption.'"<sup>47</sup> Thus, even if the purchaser is not aware of the dangers associated with a particular use of a product, a supplier has no duty to warn about those dangers if: (1) the product is not unreasonably dangerous when used in a "reasonably expectable" way; (2) the purchaser intends to use the product in a way that is not

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41. *Hinkle v. Niehaus Lumber Co.*, 510 N.E.2d 198 (Ind. Ct. App. 1987), *vacated*, 525 N.E.2d 1243 (Ind. 1988).

42. *Id.* at 202.

43. *Id.* (citations omitted).

44. *Id.*

45. *Hinkle*, 525 N.E.2d at 1245.

46. *Id.*

47. *Id.* at 1246 (quoting IND. CODE § 33-1-1.5-2.5(c) (1988)).



"reasonably expectable;" and (3) the supplier has no reason to know that the purchaser intends to use the product in a way that is not "reasonably expectable."<sup>48</sup> Indiana's products liability statute provides: "If an injury results from handling, preparation for use, or consumption that is not reasonably expectable, the seller is not liable under this chapter."<sup>49</sup> *Hinkle* is consistent with that provision.

A notable feature of this case is Justice Givan's concurring opinion, which Justice Pivarnik joined. Justice Givan concurred in the result but could not agree with the majority's statement that "Indiana's Product Liability Act imposes strict liability in tort upon sellers of a product in a defective condition unreasonably dangerous to any user or consumer."<sup>50</sup> In Justice Givan's view, "The use of the term 'strict liability' in [the products liability] statute is a misnomer and a corruption of the term, for what follows in the statute is actually legislative statement of what constitutes liability under certain acts of negligence. . . ."<sup>51</sup> Justice Givan concluded that, "[i]n *all* instances, both under the case law and the statutory law of this state, some act of negligence is required to impose liability. The result in this case does not transcend that principle."<sup>52</sup>

2. *When Does the "Open and Obvious Danger" Rule Preclude a Duty to Provide Instructions About the Proper Use of a Product?*—In *Kroger Co. Sav-On Store v. Presnell*,<sup>53</sup> the court of appeals held that a seller has a duty to instruct the buyer about the proper use of a product to avoid dangers about which consumers are generally aware if (a) consumers are also generally aware that there is a safe way to use the product, and (b) the product is unreasonably dangerous if used in this way.<sup>54</sup>

In *Presnell*, plaintiff purchased an outdoor lounge chair from defendant. Defendant provided no instructions about proper use of the

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48. 525 N.E.2d at 1245-46.

49. IND. CODE § 33-1-1.5-2.5(c) (1988).

50. 525 N.E.2d at 1244.

51. *Id.* at 1246 (Givan, J., concurring).

52. *Id.* (emphasis added). The identity of negligence and strict liability theories is widely acknowledged in the context of warnings. *Ortho Pharmaceutical Corp. v. Chapman*, 180 Ind. App. 33, 50, 388 N.E.2d 541, 553 (1979) ("[a]s a practical matter, [whether a product is defective due to inadequate warnings] is determined by application of negligence theory"). Generally, there is little or no difference between a negligent failure to warn and an improper warning under a strict products liability theory. *See id.* at 44-47, 388 N.E.2d at 549-51. In a claim of defective design or manufacture, however, the concept of "reasonableness" is addressed to the plaintiff's expectations about the use and safety of the product, not (as in a negligence case) the defendant's actions. *See, e.g.,* IND. CODE §§ 33-1-1.5-2.5(a), -3(b)(1) (1988).

53. 515 N.E.2d 538 (Ind. Ct. App. 1987).

54. *Id.* at 544.

chair. The first time plaintiff attempted to use the chair, she opened the chair legs until they were vertical and resisted further opening. She was injured when she sat in the chair, it collapsed, and she fell onto a concrete patio.<sup>55</sup>

Plaintiff alleged that the chair was defective and unreasonably dangerous because defendant “fail[ed] to give any instruction or warnings specifically about how to open the lounge chair to ensure that the locking devices were properly engaged . . . .”<sup>56</sup> Defendant argued, among other things, that “the danger of the chair’s collapse and the manner and method of opening the chair, were open and obvious and therefore Kroger was under no duty to warn or instruct Presnell how to open the chair.”<sup>57</sup>

At trial, plaintiff testified that she knew that there were no warnings or instructions about how to open the chair and that she did not think that it was necessary to ask the defendant how to open the chair.<sup>58</sup> Plaintiff’s expert, Professor Cole, testified “that instructions were needed with this chair because it differs from the ordinary folding chair . . . . [and] the user would be led to believe that when the legs are vertical and resistance is encountered, the chair is properly opened and ready for use.”<sup>59</sup> He also testified that defendant should have instructed users the chair would not lock until the legs were pushed against the resistance and past the vertical position.<sup>60</sup>

Defendant argued that the trial court erred by denying defendant’s motion for judgment on the evidence.<sup>61</sup> The court of appeals disagreed:

One of the critical points of Professor Cole’s testimony is that even though users are generally aware of the dangers of failing to properly open and secure the support legs of a lounge chair, they believe there is a safe way to do it, namely, by unfolding the legs to a vertical position until resistance is encountered. If people do in fact generally hold such a belief, then it cannot be said, as a matter of law, that the risk of back and neck injury or epilepsy from the collapse of a lounge chair

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55. *Id.* at 539.

56. *Id.*

57. *Id.* at 540.

58. *Id.* at 542.

59. *Id.* at 544.

60. *Id.*

61. *Id.* at 543. Kroger also argued that any failure to warn claim was barred because the absence of a warning was “open and obvious.” *Id.* The court summarily rejected that claim. “[I]t is the *danger* posed to the user that must be open and obvious to the consumer . . . , not the absence of a warning of the danger.” *Id.* (emphasis in original).



and a fall to the cement patio is open and obvious. . . .

“Whether a danger is open and obvious depends not just on what people can see with their eyes but also what they know and believe about what they see. In particular, if people generally believe that there is a danger associated with the use of a product, but that there is a safe way to use it, any danger there may be in using the product in the way generally believed to be safe is not open and obvious.”

Both Cole and Presnell testified that the chair legs, when pushed into a 90 degree vertical position, then encountered resistance. We find this testimony was sufficient to make the following issues questions of fact for the jury to resolve: (1) whether Kroger had a duty to warn prospective users of the danger inherent in the failure to properly set up the chair for use; (2) whether the danger inherent in the failure to properly engage and secure the support legs of the chair in a locked position before use was open and obvious; and (3) whether the chair's design or mechanical condition was defective and unreasonably dangerous.<sup>62</sup>

Accordingly, the court held that the trial court properly denied defendant's motion for judgment on the evidence.<sup>63</sup> Thus, *Presnell* stands for the proposition that a seller has a duty to instruct the buyer how to use the product safely if the method for doing so differs from the method people generally believe is safe.

3. *Continuing Duty to Warn*.—In *Reed v. Ford Motor Co.*,<sup>64</sup> Ford moved to dismiss the plaintiff's claim that Ford had a continuing duty to warn of alleged defects in a vehicle. The court denied the motion. The court reasoned that the statute that defines “defective condition,” which includes the limiting phrase “at the time [the product] is conveyed by the seller to another party,” does not relate to a failure to warn.<sup>65</sup> The warning provision is in a separate subpart that contains no language limiting the time when warnings should be given.<sup>66</sup> The court concluded

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62. *Id.* at 544 (quoting *Corbin v. Coleco Indus., Inc.*, 748 F.2d 411, 417-18 (7th Cir. 1984)) (citations omitted).

63. *Id.* Summary judgment in favor of a manufacturer is proper if the plaintiff states that she used a product in a way she believed was safe but presents no expert or other users who testify that plaintiff's method was *generally* considered safe. *Koske v. Townsend Eng'g Co.*, 526 N.E.2d 985, 993 (Ind. Ct. App. 1988).

64. 679 F. Supp. 873 (S.D. Ind. 1988).

65. *Id.* at 879 (quoting IND. CODE §§ 33-1-1.5-2.5(a), (b) (1988)).

66. *Id.*

that "the Indiana legislature intended [the two subsections] to be distinct and did not intend to have the time of sale restriction applicable to 'reasonable warnings.'" <sup>67</sup> The court also denied a motion to dismiss on the theory that the time a warning must be given is limited to the time of sale by Indiana common law. <sup>68</sup>

*C. Second Collision Cases: Will Indiana Recognize the  
"Crashworthiness" Doctrine?*

Twelve years ago, the Seventh Circuit Court of Appeals predicted that, if given an opportunity to do so, the Supreme Court of Indiana would adopt the "crashworthiness" theory of liability. <sup>69</sup> According to the leading case on the crashworthiness doctrine, *Larsen v. General Motors Corp.*, <sup>70</sup> a crashworthiness or "second collision" case is one in which "[t]he plaintiff does not contend that the design caused the accident but that because of the design he received injuries he would not have otherwise received or, in the alternative, his injuries would not have been as severe." <sup>71</sup> A fundamental rationale underlying the crashworthiness doctrine is that automobile accidents are foreseeable. <sup>72</sup> Consequently, the argument runs, the manufacturer should be held to a duty of reasonable care to design the automobile "consonant with the state of the art to minimize the effect of accident." <sup>73</sup>

Unlike most tort actions, in a crashworthiness case someone other than the defendant causes the accident—the first collision—that leads to the plaintiff's injuries. Thus, in order to accept the crashworthiness theory one must accept the proposition that the plaintiff can separate the cause of the first collision and its resulting harm from the cause of the second collision and its resulting harm. <sup>74</sup>

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67. *Id.*

68. *Id.* at 879-80.

69. *Huff v. White Motor Corp.*, 565 F.2d 104, 109 (7th Cir. 1977).

70. 391 F.2d 495 (8th Cir. 1968).

71. *Id.* at 497.

72. *Id.* at 502.

73. *Id.* at 503.

74. In *Larsen*, the leading crashworthiness case, the court noted:

Any design defect not causing the accident would not subject the manufacturer to liability for the entire damage, but the manufacturer should be liable for that portion of the damage or injury caused by the defective design over and above the damage or injury that probably would have occurred as a result of the impact or collision absent the defective design.

*Id.* at 503. This apportionment-of-harm issue is the subject of one of the major debates among the courts. Compare *Huddell v. Levin*, 537 F.2d 726 (3d Cir. 1976) with *Mitchell v. Volkswagenwerk, AG*, 669 F.2d 1199 (8th Cir. 1982). The *Huddell* court held, "[T]he plaintiff must offer some method of establishing the extent of enhanced injuries attributable



In *Miller v. Todd*,<sup>75</sup> plaintiff requested the court of appeals to recognize the crashworthiness doctrine, but the court did not decide the issue.<sup>76</sup> In *Miller*, plaintiff was injured in a motorcycle accident. She alleged that the motorcycle was defective—*i.e.*, not crashworthy—because it did not have crash bars. Defendants argued that the absence of crash bars is open and obvious.<sup>77</sup>

The court declined the opportunity to recognize the crashworthiness doctrine:

The critical inquiry is whether the manufacturer has provided a product in a defective condition unreasonably dangerous to

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to the defective design.” 537 F.2d at 738. The *Mitchell* court found that *Huddell* was asking the plaintiff to bear an impossible burden: “A rule of law which requires a plaintiff to prove what portion of indivisible harm was caused by each party and what might have happened in lieu of what did happen requires obvious speculation and proof of the impossible.” 669 F.2d at 1205.

The counter-argument was well-stated in *Huddell*:

It was plaintiff, not G.M., who introduced divisibility into the litigation by arguing that the accident was survivable but for the defect in the design of the head restraint. Plaintiff cannot have the argument both ways. Plaintiff may not argue that the ultimate fact of death is divisible for purposes of establishing G.M.’s liability and then assert that it is indivisible in order to deny to G.M. the opportunity of limiting damages. . . . We simply do not accept the G.M. the opportunity of limiting damages. . . . We simply do not accept the proposition that suing for wrongful death suffices to convert limited, second collision, enhanced injuries liability into plenary liability for the entire consequences of an accident which the automobile manufacturer played no part in precipitating. 537 F.2d at 739.

Those who refuse to follow *Huddell* usually reason that the law should require the defendant rather than the faultless plaintiff to prove which portion of plaintiff’s injuries were caused by the uncrashworthy design and which portion would have occurred despite the design. See, e.g., *Huddell*, 537 F.2d at 746 (Rosenn, J., concurring). As a matter of policy, the defendant should bear this burden. This rationale disintegrates, and should not apply, if the plaintiff sues on a strict liability theory under which the defendant is liable without fault. See, e.g., IND. CODE § 33-1-1.5-3(b)(1) (1988). This rationale makes even less sense if the plaintiff’s fault caused or contributed to the cause of the accident. Even if it is improper to consider the plaintiff’s conduct when determining whether a design is defective, it is proper to consider the plaintiff’s conduct when deciding whether, as a matter of policy, the plaintiff or the defendant must prove the causal relationship between the design and plaintiff’s injuries.

In a case decided after the survey period, *Masterman v. Veldman’s Equip., Inc.*, 530 N.E.2d 312 (Ind. Ct. App. 1988), the court of appeals sided with those courts following the *Huddell* case. The court cited two reasons for imposing the burden of proof on the plaintiff. First, plaintiff must prove the “specific injuries caused by the defective product.” *Id.* at 317 (emphasis added). Second, the rule apportions liability for damages in accordance with the fault of the manufacturer or seller. *Id.* at 318. —*Ed.*

75. 518 N.E.2d 1124 (Ind. Ct. App. 1988).

76. *Id.* at 1125-26.

77. *Id.* at 1125.

the user. . . . The plaintiff must establish a *latent defect* before the focus narrows on whether the hidden danger created an unreasonable risk of harm. Only then do we consider the extent of a manufacturer's duty to design and produce a crashworthy vehicle.

. . . .

As a matter of law, the absence of crash bars on a motorcycle is an open and obvious danger to the ordinary user.<sup>78</sup>

Accordingly, the court affirmed the summary judgment in favor of defendants.<sup>79</sup>

The court, however, did discuss the crashworthiness doctrine:

The crashworthiness doctrine recognizes that the intended use of a vehicle encompasses the inevitability of collisions and requires the manufacturer to design a vehicle reasonably safe for those foreseeable risks. . . . [T]here is no Indiana caselaw or statutory authority recognizing the doctrine. However, our resolution of this appeal does not depend upon whether Indiana adheres to the crashworthiness doctrine. The crashworthiness doctrine is merely a variation of the strict liability theory, extending a manufacturer's liability to situations in which the defect did not cause the accident or initial impact, but rather increased the severity of the injury.<sup>80</sup>

In *Wixom v. Gledhill Road Machinery Co.*,<sup>81</sup> plaintiffs argued for precisely this theory of liability. In *Wixom*, plaintiff's decedent had been driving on an icy road when another car, driven by Waltz, struck the rear of decedent's car. The collision caused decedent's car to skid out of control, across the median, and into the path of a snowplow. The blade of the snowplow penetrated the passenger compartment of the car, killed the decedent, and injured another occupant, also a plaintiff.<sup>82</sup>

Plaintiffs sued the blade manufacturer. They alleged that, because the accident was foreseeable, the manufacturer should have provided torus segments on the blade to reduce the risk that the blade would penetrate the passenger compartment. Consequently, they alleged, the blade was defective and the defective condition became "operative" when the car struck the blade.<sup>83</sup> The trial court granted the manufacturer's

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78. *Id.* at 1126 (citations omitted) (emphasis in original).

79. *Id.* at 1125.

80. *Id.* at 1125-26 (citations omitted).

81. 514 N.E.2d 306 (Ind. Ct. App. 1987).

82. *Id.* at 307.

83. *Id.*



motion for summary judgment, and the court of appeals affirmed.<sup>84</sup>

The court affirmed the judgment on two grounds. First:

Gledhill's liability, if any, could only have become "operative" at the time it placed such product into the stream of commerce, not afterward. Gledhill was not in actual or constructive possession or control of its snowplow blade at the time the accident . . . occurred. Thus, the trial court correctly determined Waltz's negligent rear-ending of the Wixom vehicle was an act intervening between Gledhill's allegedly wrongful act and the Wixom's injuries and death.<sup>85</sup>

Second, the alleged defect merely created a condition that made the injuries possible because of Waltz's negligent act; when the defendant merely creates a condition that makes subsequent injury-producing negligent acts possible, those negligent acts are not foreseeable, as a matter of law, and the condition cannot be the proximate cause of the injuries.<sup>86</sup>

Unless motor vehicle manufacturers are singled out as a special class of defendants,<sup>87</sup> there is no legally sound basis for distinguishing *Wixom* from an automobile crashworthiness case.<sup>88</sup> As a matter of common sense, if not common law, it is no more foreseeable that automobile accidents will occur than that snowplows will be used on icy roads and that a car may slide across any icy road into the path of the snowplow. If *Wixom* is the law, it is difficult to see how the crashworthiness doctrine can be.<sup>89</sup>

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84. *Id.* at 306.

85. *Id.* at 308.

86. *Id.* at 308-09.

87. The *Larsen* court noted, "We think the duty of the use of reasonable care in design to protect against foreseeable injury to the user of a product . . . should be and is equally applicable to all manufacturers." *Larsen v. General Motors Corp.*, 391 F.2d 495, 504 (8th Cir. 1968). The court expressly rejected the idea that the "crashworthiness doctrine should apply only to automobile manufacturers." *Id.*

88. The crashworthiness doctrine has been applied to vehicle manufacturers where the plaintiff was not a passenger. See *Knippen v. Ford Motor Co.*, 546 F.2d 993 (D.C. Cir. 1976); *Green v. Volkswagen of Am., Inc.*, 485 F.2d 430 (6th Cir. 1973); *Passwaters v. General Motors Corp.*, 454 F.2d 1270 (8th Cir. 1972). Thus, *Wixom* cannot be distinguished on the ground that plaintiffs were not passengers in the manufacturer's allegedly defective product.

89. It is likely that *Wixom* is not the law. In *Masterman v. Veldman's Equip., Inc.*, 530 N.E.2d 312 (Ind. Ct. App. 1988), the court of appeals, apparently oblivious to *Wixom*, specifically held, in reversing the grant of summary judgment to the seller and manufacturer of the snowplow mount which allegedly enhanced the Mastermans' injuries, that the Mastermans did have a cause of action for those injuries. *Id.* at 315.—*Ed.*

*D. Design Defects: The Open and Obvious Danger Rule Does Not Preclude Liability if the Manufacturer's Conduct Is Willful and Wanton*

In *Koske v. Townsend Engineering Co.*,<sup>90</sup> a divided court of appeals held that the open and obvious danger rule “does not necessarily preclude a manufacturer’s liability for claims of willful or wanton misconduct asserted by the injured plaintiff.”<sup>91</sup> In *Koske*, the plaintiff worked in a meat processing plant. Her primary job station was adjacent to a skinner/slasher machine manufactured by the defendant. The skinner/slasher processed pork jowls. Ordinarily a conveyor moved the jowls into the machine’s rotating blades. The machine had no safety guards.<sup>92</sup>

Sometimes the machine became a production bottleneck. When that happened, plaintiff assisted on the machine. One day the machine had been shut down and sanitized. Because the machine had been sanitized, the conveyor was slick. In addition, the jowls that were being processed were frozen and stiff, so it was necessary to push the jowls into the blades. Consequently, plaintiff used one jowl to push another into the machine. She had used this procedure often. This time the jowl that she was using to push slid over the other jowl, and plaintiff’s hand was caught in the machine.<sup>93</sup>

Defendant advertised that the machine had “improved operator safety” because the operator’s hands would be at least eighteen inches from the blades. Nevertheless, defendant knew that under certain conditions the conveyor would not automatically feed jowls into the blades. Defendant was aware of several similar accidents in other meat processing plants. In a letter to a meat processing company written ten months before plaintiff’s accident, defendant acknowledged the potential safety hazard and urged that the machine be removed as soon as possible. Less than a month after plaintiff’s accident, defendant recalled the machine and stated that it was aware of “several instances” where the machine had caused or was thought to have caused hand or arm injuries.<sup>94</sup> Experts agreed that the machine was not adequately guarded. Defendant replaced the model plaintiff had used with a new model that had guards and safety switches. The new model also had a warning sign.<sup>95</sup>

Plaintiff sought recovery “under a theory of strict liability for a defective design resulting in an unreasonably dangerous product and

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90. 526 N.E.2d 985 (Ind. Ct. App. 1988).

91. *Id.* at 990.

92. *Id.* at 987.

93. *Id.*

94. *Id.* at 987-88.

95. *Id.* at 988.



under a theory of willful and wanton misconduct.”<sup>96</sup> Plaintiff argued that the open and obvious danger rule should not bar claims based on blameworthy conduct. Defendant argued that a product with an open and obvious danger is not defective or unreasonably dangerous. Thus, it did not willfully or wantonly provide a product that was defective.<sup>97</sup> The trial court concluded that the open and obvious danger rule barred plaintiff’s claim and granted defendant’s motion for summary judgment.<sup>98</sup>

The court of appeals reversed. The court, reasoning by analogy to *Bridgewater v. Economy Engineering Co.*,<sup>99</sup> found: “the defenses of contributory willful or wanton misconduct and incurred risk adequately cover a claim of willful or wanton misconduct without borrowing other doctrines.”<sup>100</sup> Consequently, “if the injured person was reckless with regard to his or her own safety, recovery against even a reckless manufacturer will be barred. . . .”<sup>101</sup> The court noted that the open and obvious danger rule announced in *Bemis Co. v. Rubush*<sup>102</sup> expressly applied only to product liability actions based on negligence or strict liability.<sup>103</sup> The court reasoned:

*A fortiori*, consistent limitation of the principle would entail application of the open and obvious danger rule to product liability claims involving only negligence and strict liability actions.

The rationale for precluding the open and obvious danger rule as an automatic bar to recovery for a plaintiff in claims of willful and wanton misconduct is not hard to find. The focus of willful misconduct is not on the product but on the culpability of the manufacturer. When a manufacturer acts recklessly, reflecting a callous sacrifice of consumer safety for the benefit of the enterprise, the scope of a manufacturer’s legal responsibility for injuries from its defective products should reflect that measure of its culpability. The manufacturer maintains a powerful position of control over product safety and has the opportunity to consider the potential legal consequences flowing from its conduct.<sup>104</sup>

The court stated that “[t]he obviousness of the danger is but one factor.”<sup>105</sup> In order to recover under a wanton and willful conduct

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96. *Id.*

97. *Id.* at 990.

98. *Id.* at 988.

99. 486 N.E.2d 484 (Ind. 1985).

100. *Koske*, 526 N.E.2d at 991.

101. *Id.*

102. 427 N.E.2d 1058 (Ind. 1981).

103. *Koske*, 526 N.E.2d at 991.

104. *Id.* (citations omitted) (emphasis in original).

105. *Id.*

theory, "the defendant must have knowledge of facts sufficient to imply that he knew the plaintiff would not extricate himself from the peril."<sup>106</sup> According to the court, whether plaintiff acted unreasonably and whether defendant knew that plaintiff would not be able to extricate herself from a danger known to defendant were genuine issues of material fact that precluded summary judgment.<sup>107</sup>

There was some evidence for a factfinder to conclude that Townsend knew that an unacceptable number of serious injuries were caused by its machine, knew that the machine was a safety hazard, and yet resisted recalling the machine in reckless disregard of the known probable consequences.<sup>108</sup>

Judge Neal dissented. He found no evidence to support plaintiff's claim that defendant's conduct was willful and wanton<sup>109</sup> and also wrote:

I fail to perceive any connection between the mental state of the manufacturer, a necessary element where wanton and willful conduct is alleged, and the open and obvious rule. Before liability can be impressed upon a manufacturer the defect must be hidden and not normally observable, thus creating a latent danger in the use of the product. . . . [T]he open and obvious concept is addressed to the knowledge and mental processes of the user. When he perceives the danger and continues to use the product, the original act of the manufacturer, or his mental state, is no longer a causative factor.<sup>110</sup>

#### *E. The "Learned Intermediary" Doctrine Applies to Medical Devices*

In *Phelps v. Sherwood Medical Industries*,<sup>111</sup> the Seventh Circuit Court of Appeals, applying Indiana law, extended the "learned intermediary" doctrine to medical devices.<sup>112</sup> Previously, the Court of Appeals

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106. *Id.*

107. *Id.* at 991-92.

108. *Id.* at 992.

109. *Id.* at 993 (Neal, J., dissenting).

110. *Id.*

111. 836 F.2d 296 (7th Cir. 1987).

112. The court relied on the definition of medical "device" in the Food, Drug and Cosmetic Act, Pub. L. No. 717, 52 Stat. 1048 (codified as amended at 21 U.S.C. §§ 301 to 392 (1982)). 836 F.2d at 298-99. The act as amended defines medical "device" as an instrument, apparatus, implement, machine, contrivance, implant, in vitro reagent, or other similar or related article, including any component, part, or accessory, which is—

(1) recognized in the official National Formulary, or in the United States



of Indiana had held, in *Ortho Pharmaceutical Corp. v. Chapman*,<sup>113</sup> that the doctrine applies to an oral contraceptive available only with a prescription.<sup>114</sup> According to the *Chapman* court:

Where a product is available only on prescription or through the services of a physician, the physician acts as a "learned intermediary" between the manufacturer or seller and the patient. . . . [I]f the product is properly labeled and carries the necessary instructions and warnings to apprise the physician of the proper procedures for use and the dangers involved, the manufacturer may reasonably assume that the physician will exercise the informed judgment thereby gained in conjunction with his own independent learning, in the best interest of the patient.<sup>115</sup>

Accordingly, a prescription drug "manufacturers [sic] duty to warn extends only to the medical profession, and not the ultimate users."<sup>116</sup> The rationale for the rule is that

Prescription drugs are likely to be complex medicines, esoteric in formula and varied in effect. As a medical expert, the prescribing physician can take into account the propensities of the drug, as well as the susceptibilities of his patient. His is the task of weighing the benefits of any medication against its potential dangers. The choice he makes is an informed one, an individualized medical judgment bottomed on a knowledge of both patient and palliative.<sup>117</sup>

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Pharmacopeia, or any supplement to them,

(2) intended for use in the diagnosis of disease or other conditions, or in the cure, mitigation, treatment, or prevention of disease, in man or other animals, or

(3) intended to affect the structure or any function of the body of man or other animals, and which does not achieve any of its principal intended purposes through chemical action within or on the body of man or other animals and which is not dependent upon being metabolized for the achievement of any of its principal intended purposes.

21 U.S.C. § 321(h) (1982).

113. 180 Ind. App. 33, 388 N.E.2d 541 (1979).

114. Some courts have not applied the learned intermediary doctrine to oral contraceptives and have extended the manufacturer's duty to warn beyond the doctor to the consumer. See cases cited in *Phelps*, 836 F.2d at 299. "[S]ince the dispenser of those products may not be a physician (as in a clinic), the careful balancing of risks to the individual patient may not occur, and therefore an extended warning is appropriate." *Id.*

115. *Chapman*, 180 Ind. App. at 44, 388 N.E.2d at 549 (quoting *Terhune v. A.H. Robins Co.*, 90 Wash. 2d 9, —, 577 P.2d 975, 978 (1978)).

116. *Chapman*, 180 Ind. App. at 43, 388 N.E.2d at 548.

117. *Id.* at 44, 388 N.E.2d at 549 (quoting *Reyes v. Wyeth Laboratories, Inc.*, 498 F.2d 1264, 1276 (5th Cir.), cert. denied sub nom. *Wyeth Laboratories v. Reyes*, 419 U.S. 1096 (1974)).

In *Phelps*, a surgeon, Rubush, inserted a catheter into Phelp's heart that defendant, Sherwood, had manufactured. The surgeon attached the catheter with a "purse-string" suture. Later, while a nurse attempted to remove the catheter, it broke, and part of it remained in plaintiff's heart. The nurse testified that she would not have attempted to remove the catheter had she known that it was sutured to plaintiff's heart.<sup>118</sup> Rubush testified that he was aware that the catheter had broken in similar situations and that suturing the catheter as he had done would prevent its removal.<sup>119</sup> Only doctors could lawfully purchase the catheter.<sup>120</sup>

Plaintiff alleged that the catheter was defective because, instead of stretching before separating, it broke. Defendant had provided a warning to the surgeon. Plaintiff did not argue that this warning was inadequate, but he claimed that defendant had a duty to warn plaintiff, or at least to warn the nurse.<sup>121</sup> Defendant argued that its duty to warn extended only to the surgeon, who should have passed the warning on to the nurse and plaintiff.<sup>122</sup>

A jury returned a verdict for defendant. On appeal, plaintiff argued that the trial court erred when it instructed the jury on the defendant's duty to warn.<sup>123</sup> The trial court instructed the jury that the surgeon was the user of the catheter, and

If you find from the evidence in this case that Doctor Rubush had knowledge, in his intended use of this Defendants' [sic] catheter, that there was danger of breaking of said catheter upon attempted removal because of the route and obstructions existent in the application of this catheter, then you are instructed that the Defendants had no duty to warn with respect to such potential properties since they were already known *to the user, the operating surgeon*.<sup>124</sup>

The Seventh Circuit affirmed. First, the court determined that the surgeon was a "user or consumer."<sup>125</sup> The court noted that, under the statute,<sup>126</sup> a "user or consumer" includes "*any other person who, while acting for or on behalf of the injured party, was in possession and*

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118. *Phelps*, 836 F.2d at 299.

119. *Id.*

120. *Id.* at 302.

121. *Id.* at 300.

122. *Id.*

123. *Id.*

124. *Id.* (emphasis in original).

125. *Id.* at 301-03.

126. IND. CODE § 33-1-1.5-2 (1988).



control of the product in question . . . ."<sup>127</sup> The court also noted that the term "consumers" includes "not only those who in fact consume the product, *but also who prepare it for consumption . . .*,"<sup>128</sup> and that "user" includes "*those who are utilizing [the product] for the purpose of doing work upon it . . .*."<sup>129</sup> The court reasoned:

[The surgeon] received the label warning from Sherwood and thus should certainly be considered as a "user" of the catheter. [The surgeon] also fits into the Restatement's definition of "consumer" since he prepared and employed the catheter for ultimate "consumption" by Phelps. Even more significantly, he utilized the catheter for the purpose of surgery.<sup>130</sup>

Second, relying on *Chapman* and *Ingram v. Hook's Drugs, Inc.*,<sup>131</sup> the court determined that the "learned intermediary" doctrine applies to medical devices:<sup>132</sup>

In *Chapman*, the prescription drug manufacturer discharged its duty to warn by warning a patient's physician. The physician then had a duty to inform himself of the drug's propensities before using it on his patients. This "learned intermediary" exception has equal application to those cases concerning medical devices. Phelps tries here to distinguish the Indiana law regarding prescription drugs from situations involving medical devices. Yet this Court can find no principled basis for such a distinction. Applying *Chapman* and *Ingram* to this field, it was up to Dr. Rubush, the heart surgeon who, according to the evidence, knew the risks and benefits of this kind of catheter usage, to warn Phelps.<sup>133</sup>

Because "medical devices" includes a broad variety of products, *Phelps* is an important extension of the learned intermediary doctrine. The term "medical devices" includes products that persons other than

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127. *Phelps*, 836 F.2d at 301 (emphasis in original) (citing IND. CODE § 33-1-1.5-2 Supp. 1983).

128. *Phelps*, 836 F.2d at 302 (emphasis in original) (citing RESTATEMENT (SECOND) OF TORTS § 402A comment 1 (1977)).

129. *Phelps*, 836 F.2d at 302 (emphasis in original) (citing RESTATEMENT (SECOND) OF TORTS § 402A comment 1 (1977)). Cf. *Thiele v. Faygo Beverage, Inc.*, 489 N.E.2d 562 (Ind. Ct. App.) ("user or consumer" does not include seller's employee who handles the product before the consumer buys it).

130. *Phelps*, 836 F.2d at 302-03.

131. 476 N.E.2d 881 (Ind. Ct. App. 1985).

132. *Phelps*, 836 F.2d at 303.

133. *Id.* (citations omitted).

doctors may lawfully obtain.<sup>134</sup> *Phelps* seems to include those products, but plaintiffs may argue that the "learned intermediary" doctrine should apply to products that only a doctor may lawfully obtain. Because Indiana law limits the conditions under which a doctor is liable for failing to warn<sup>135</sup> and limits a plaintiff's damages even if the doctor is liable,<sup>136</sup> both plaintiffs and defendants are likely to test the scope of the *Phelps* holding.

*F. Split Authority in the Southern District: Does the Discovery Rule Apply to the Statute of Repose?*

Section five of the Indiana Product Liability Act<sup>137</sup> continues to be the subject of several published opinions.<sup>138</sup> That section provides:

[A]ny product liability action in which the theory of liability is negligence or strict liability in tort must be commenced within two (2) years after the cause of action accrues or within ten (10) years after the delivery of the product to the initial user or consumer; except that, if the cause of action accrues more than eight (8) years but not more than ten (10) years after the initial delivery, the action may be commenced at any time within two (2) years after the cause of action accrues.<sup>139</sup>

Recently, judges in the Southern District of Indiana have considered whether the statute of repose bars a plaintiff's action if the product, asbestos, caused injuries that did not manifest themselves within the

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134. For example, water treatment devices that are generally available to the public are an integral part of hemodialysis treatment for some persons with end-stage renal disease. These devices treat the water that is mixed, in a dialysis machine, with a concentrated solution. The diluted solution passes through an artificial kidney, which removes, from the patient's blood, the wastes that the natural kidneys are unable to remove. A more or less ordinary water treatment device, when used for such purposes, is a "machine . . . intended for use in the . . . treatment . . . of disease, in man . . . ." 21 U.S.C. § 321(h) (1982). Consequently, it would be a medical device, at least when used for the medical purpose.

135. See *Kranda v. Houser-Norborg Medical Corp.*, 419 N.E.2d 1024 (Ind. Ct. App.) (1981), *reh'g denied* 424 N.E.2d 1064 (1981), *appeal dismissed* 459 U.S. 802 (1982); *Revord v. Russell*, 401 N.E.2d 763 (Ind. Ct. App. 1980).

136. See IND. CODE § 16-9.5-2-2 (1988).

137. Act approved March 10, 1978, Pub. L. 141, § 28, 1978 Ind. Acts 1298, 1308-10 (codified as amended at IND. CODE §§ 33-1-1.5-1 to -5 (1988)).

138. Among the published opinions that have considered section five are: *Barnes v. A.H. Robins Co.*, 476 N.E.2d 84 (Ind. 1985); *Dague v. Piper Aircraft Corp.*, 275 Ind. 520, 418 N.E.2d 207 (1981); *Orr v. Turco Mfg. Co.*, 484 N.E.2d 1300 (Ind. Ct. App. 1985); *Whittaker v. Federal Cartridge Corp.*, 466 N.E.2d 480 (Ind. Ct. App. 1984); *Scalf v. Berkel, Inc.*, 448 N.E.2d 1201 (Ind. Ct. App. 1983).

139. IND. CODE § 33-1.5-1-5 (1988).



statutory period of repose. One judge held that the statute did not bar plaintiff's action;<sup>140</sup> the other judge held that it did.<sup>141</sup>

1. *Background*.—The leading case dealing with the statute of repose provision is *Dague v. Piper Aircraft Corp.*<sup>142</sup> In *Dague*, the Indiana Supreme Court held: "the action must be brought within two years after it accrues, but in any event within ten years after the product is first delivered to the initial user or consumer, unless the action accrues more than eight but less than ten years after the product's introduction into the stream of commerce."<sup>143</sup> The product was an airplane that the defendant, the manufacturer, first had sold on March 26, 1965. The airplane crashed on July 7, 1978, and plaintiff's decedent died on September 5, 1978. Plaintiff filed her wrongful death action on October 1, 1979.<sup>144</sup> Although plaintiff filed her action within two years after the crash, the court held "that section five of the Product Liability Act bars plaintiff's action in this cause, inasmuch as the damages incurred by plaintiff occurred more than ten years after the product was first placed in commerce."<sup>145</sup> The court also held that plaintiff did not have a vested common law right in her cause of action and that the legislature did not exceed its constitutional authority when it enacted the statute of repose and effectively precluded any action against product manufacturers for injuries that occur more than ten years after the product is delivered to the first user or consumer.<sup>146</sup>

In *Barnes v. A.H. Robins Co.*,<sup>147</sup> the supreme court held that a cause of action accrues and the two-year personal injury statute of limitations<sup>148</sup> begins to run on the date that the plaintiff knew or should

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140. *Covalt v. Carey-Canada, Inc.*, 672 F. Supp. 367 (S.D. Ind. 1987), *question certified to Indiana Supreme Court*, 860 F.2d 1434 (7th Cir. 1988); *accord* *Blaker v. U.S. Mineral Prods. Co.*, 688 F. Supp. 1300 (S.D. Ind. 1987).

141. *Knox v. AC & S, Inc.*, 690 F. Supp. 752 (S.D. Ind. 1988); *accord* *England v. Asbestos Corp.*, No. IP 81-163-C (S.D. Ind. Feb. 13, 1987).

142. 275 Ind. 520, 418 N.E.2d 207 (1981).

143. *Id.* at 525, 418 N.E.2d at 210.

144. *Id.* at 522, 418 N.E.2d at 209.

145. *Id.* at 526, 418 N.E.2d at 211.

146. *Id.* at 528-30, 418 N.E.2d at 212-13.

147. 476 N.E.2d 84 (Ind. 1985).

148. IND. CODE § 34-1-2-2 (1988). *Barnes* was based upon a certified question from the Seventh Circuit:

"When does a cause of action accrue within the meaning of the Indiana Statute of Limitations for personal injury accidents, IND. CODE § 34-1-2-2, and the Indiana Statute of Limitations for Products Liability actions, IND. CODE § 33-1-1.5-5, when the injury to the plaintiff is caused by a disease which may have been contracted as a result of protracted exposure to a foreign substance?"

*Barnes*, 476 N.E.2d at 85. The supreme court's discussion appeared to be limited to the two-year limitations statute. *See, e.g.*, 476 N.E.2d at 87 ("[W]e find that . . . the statute

have discovered the causal connection between her injuries and the defective product or negligent act, if the injuries are the result of protracted exposure to a seemingly innocent, foreign substance that "causes changes so subtle and latent that they are not discoverable to the plaintiff until they manifest themselves many years later."<sup>149</sup> In *Barnes*, plaintiffs had filed their actions more than two years after the product had caused the harm, less than two years after the plaintiffs actually discovered the causal connection between the product and their injuries, and less than ten years after the product had been delivered to the initial user.<sup>150</sup>

In *Walters v. Owens-Corning Fiberglass Corp.*,<sup>151</sup> the Seventh Circuit held that the *Barnes* discovery rule applies to actions based on protracted exposure to asbestos products. In *Walters*, the plaintiff, who had worked as an asbestos insulation applicator from 1950 to 1975, learned in February 1978 that he had an asbestos-related disease. He filed his complaint approximately two years later.<sup>152</sup> The court rejected defendants' argument that the *Barnes* rule does not apply to asbestos and held that, "exposure to asbestos products over a period of twenty-five years (and presumably lesser periods) constitutes 'protracted exposure to a foreign substance.'"<sup>153</sup>

2. *The Facts and Arguments.*—In *Covalt v. Carey-Canada, Inc.*<sup>154</sup> and *Knox v. AC & S, Inc.*,<sup>155</sup> the defendants moved for summary judgment on the ground that the plaintiffs filed their complaints more than ten years after the last delivery of asbestos insulation to their employers.<sup>156</sup> The defendants contended that the statute of repose pro-

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of limitations in such causes commences to run from the date the plaintiff knew or should have discovered that she suffered an injury or impingement. . . ."). The facts stated in *Barnes* indicate that the statute of repose did not bar plaintiffs' claims under any reading of the statute; each plaintiff had sued within ten years of the initial insertion of her Dalkon shield. 476 N.E.2d at 84-85.

149. *Barnes*, at 86.

150. *Id.* at 84-85.

151. 781 F.2d 570 (7th Cir. 1986).

152. *Id.* at 571.

153. *Id.* at 572.

154. 672 F. Supp. 367 (S.D. Ind. 1987).

155. 690 F. Supp. 752 (S.D. Ind. 1988).

156. In *Knox*, the plaintiff presented evidence that there had been some asbestos deliveries within the period of repose, and the defendants submitted affidavits that indicated that all asbestos deliveries ceased outside the repose period. *Id.* at 759. Consequently, the court held that "a question of fact remains concerning whether the plaintiff can prove delivery and exposure to any of the defendants' products during the period of repose, so as to avoid the effect of the statute of repose and its absolute bar to plaintiff's cause of action." *Id.*



vision is an absolute bar to actions that are filed outside the repose period.

Both the plaintiffs and the defendants presented persuasive arguments for their respective positions. The plaintiffs relied on *Barnes* and *Walters* and argued that the *Dague* statute of repose rule does not apply in asbestos cases because their injuries were not discoverable within the repose period. Indeed, there is language in the *Barnes* opinion that seems to support this position:

The [discovery] rule is based on the reasoning that it is inconsistent with our system of jurisprudence to require a claimant to bring his cause of action in a limited period in which, even with due diligence, he could not be aware a cause of action exists. In the typical tort claim, injury occurs at the time the negligent act is done and the claimant is either aware of the injury, or at least the cause of the injury, and is put on notice to determine the extent of that injury. The claimant, therefore, has the whole statutory time provided for in the limitations statutes to make his determinations and bring his cause of action. The problem comes about when the act, seemingly innocent, causes changes so subtle and latent that they are not discoverable to the plaintiff until they manifest themselves many years later.<sup>157</sup>

In addition, the *Barnes* court expressly stated that the legislature's authority to limit the time in which a plaintiff can file an action is not so broad that the legislature can provide for a period that "is so manifestly insufficient that it represents denial of justice."<sup>158</sup> Finally, in *Dague* the statute of repose barred plaintiff's action because "damages incurred by plaintiff occurred more than ten years after the product was first placed in commerce."<sup>159</sup> In the asbestos cases, the damages incurred by the plaintiff occur, or at least the effects may begin to occur, within the repose period, but they are not discoverable until after the repose period expires. In such cases, plaintiffs argued, *Dague* does not apply,<sup>160</sup> and *Barnes* applies by analogy, if not directly.

The defendants relying on *Dague*, argued that the statute of repose absolutely precludes any action that is filed outside the repose period,

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157. *Barnes v. A.H. Robins Co.*, 476 N.E.2d 84, 86 (Ind. 1985).

158. *Id.*

159. 275 Ind. at 526, 418 N.E.2d at 211.

160. That is, plaintiffs may argue, these asbestos cases are distinguishable from *Dague*. In *Dague*, the harm occurred after the repose period; in the asbestos cases the harm occurred, or may have occurred, during the repose period, but it was not discoverable until the repose period expired. Of course, the question is whether this distinction has any legal significance.

and noted that in both *Barnes* and *Walters* the courts considered only the time that plaintiff's cause of action accrued and the statute of limitations began to run. Neither court considered the statute of repose. In both cases, plaintiffs had filed their complaints within the repose period. In addition, the language of the statute expressly provides only one exception to the general rule that the plaintiff must commence the action within ten years after the product is delivered to the first user or consumer: where the cause of action accrues more than eight but less than ten years after the product is delivered to the first user or consumer. If, as in *Dague*, the cause of action accrues after the ten year period, the plaintiff simply has no cause of action. This is the legislature's statement of policy—no manufacturer can be exposed to liability more than twelve years after it places a product in the stream of commerce in Indiana. As the *Dague* court held, a plaintiff has no vested interest in a common law rule, and the legislature has the power and authority to limit the time when plaintiff may commence a cause of action.<sup>161</sup>

3. *The Opinions.*—In *Covalt*,<sup>162</sup> Judge McKinney denied defendants' motion for summary judgment. The court relied on *Barnes* and distinguished *Dague*:

Here we are not concerned with introduction of a product into the market place [as in *Dague*]. Here we are concerned with exposure of a foreign substance causing disease. The *Barnes* case discusses the *Dague* case and concludes that in disease cases "[t]he problem comes about when the act, seemingly innocent, causes changes so subtle and latent that they are not discoverable to the plaintiff until they manifest themselves many years later." Responding to that concern and seeming unfairness and in recognition of the difference between injury and disease, the *Barnes* case set a discovery rule to apply in protracted exposure to hazardous substance cases. To do otherwise is to exclude latent disease victims from our system of jurisprudence. No such intent should be ascribed to the Indiana Legislature or the Indiana Supreme Court. . . .

[T]he *Barnes* Court's opinion clearly sets a standard in disease cases and makes disease cases different than cases caused by products which injure individuals. In other words, it is this Court's opinion that in the State of Indiana the ten (10) year statute of repose still applies to cases like *Dague* or in any case

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161. 275 Ind. at 529, 418 N.E.2d at 213.

162. *Covalt v. Carey-Canada, Inc.*, 672 F. Supp. 367 (S.D. Ind. 1987), *question certified to Indiana Supreme Court*, 860 F.2d 1434 (7th Cir. 1988).



in which the injury to the plaintiff resulted from a product that was introduced into the stream of commerce ten years prior to the injury. The exception carved to that rule by *Barnes* is an exception that deals only with diseases from protracted exposure to foreign substances. That is, protracted exposure as opposed to a one-time injury causing event.<sup>163</sup>

In *Knox*,<sup>164</sup> Judge Tinder granted defendants' motion for summary judgment "with respect to any initial delivery and exposure that occurred more than twelve years prior to the filing of this action."<sup>165</sup> The court rejected plaintiff's argument that *Barnes* creates an exception to the statute of repose:

*Barnes* should not be read so expansively. In *Barnes*, both of the claims resulted from exposure to the hazardous substance within the period of repose and thus, the precise question in this case simply was not addressed. In addition, *Dague Corp.*, has clearly established that the statute of repose places an outside limit on liability of twelve (12) years for a products liability cause of action in Indiana. *Dague* is still the law in Indiana and it dictates that the statute of repose bars an action for damages "incurred by the plaintiff more than . . . ten years after the product was first placed in commerce." There is no language in the statute of repose which permits this court to infer that treatment under *Dague* would differ from the absolute bar to plaintiff's claim for an injury-inflicting defect occurring outside the period of repose in a case where the product causes disease with a long latency period prior to manifestation.<sup>166</sup>

Nevertheless, Judge Tinder was concerned about the rule he believed he was duty-bound to apply:

[T]he primary purpose of the statute of repose, that of recognizing the improvements of product design and safety that come

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163. *Id.* at 368 (quoting *Barnes*, 476 N.E.2d at 86 (citation omitted)).

164. *Knox v. AC & S, Inc.*, 690 F. Supp. 752 (S.D. Ind. 1988).

165. *Id.* at 759. The *Knox* court's reference to a 12-year time period was based upon the exception in the statute of repose that:

[I]f the cause of action accrues more than eight (8) years but not more than ten (10) years after the initial delivery, the action may be commenced at any time within two (2) years after the cause of action accrues.

IND. CODE § 33-1-1.5-5 (1988). If there was no delivery of the product within 12 years of the filing of the action, the claim is barred even assuming the remote theoretical possibility that the cause of action was first discovered, and so accrued, on the last day of the ten-year period.

166. 690 F. Supp. at 759 (quoting *Dague*, 275 Ind. at 526, 418 N.E.2d at 211 (citation omitted)).

with time, is not served in cases such as this one. The statute of repose essentially protects a manufacturer from being forever liable for its products, in essence rewarding a manufacturer for ongoing improvements. However, asbestos and substances like it are not subject to design and safety improvements. Asbestos will not and most probably can not improve and [sic] with time. In fact, the evidence suggests that asbestos always will be a dangerous product. As a result, it does not appear in any way to fall within the rationale of the rule; thus, the application of the statute in these types of cases creates a harsh result without advancing the countervailing policy interests underlying the adoption of the statute of repose.

The court also recognizes that the severity of the ruling in this case is magnified in light of the long latency period between exposure and manifestation in an asbestos case. Asbestosis is believed to have a manifestation period of between ten (10) to twenty-five (25) years or longer. Thus, in many, if not most instances, the plaintiff's cause of action will be time-barred before he knew or reasonably could have known that such cause of action existed. This result seems wholly inconsistent with our system of jurisprudence. In essence, the decision to adopt a discovery statute of limitations has little practical effect, because where as here, there is a long latency period of disease, the plaintiff is denied his day in court. Essentially, with the adoption of the discovery statute of limitations the plaintiff is given something with one hand, but it is immediately taken away with the other by the operation of the statute of repose. The statute of repose functions to bar the claim even though the plaintiff neither knew nor reasonably could have known that the claim existed at the time it became time-barred.

It is possible that the Indiana courts in interpreting the legislative intent with respect to the statute of repose would find that the repose period in an asbestos case was "so manifestly insufficient that it represents a denial of justice," and thus, the Indiana court might adopt the interpretation advanced by the plaintiff in this case. However, as a court sitting in diversity with the guidance of *Barnes* and *Dague*, this court cannot presume to do so.<sup>167</sup>

4. *Postscript*—On November 7, 1988, the Seventh Circuit Court of Appeals certified the following question to the Supreme Court of Indiana:

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167. *Id.* at 760 (quoting *Barnes*, 476 N.E.2d at 86 (citation omitted)).



"Whether a plaintiff may bring suit within two years after discovering a disease and its cause, notwithstanding that the discovery was made more than ten years after the last exposure to the product that caused the disease."<sup>168</sup>

*G. The Federal Statute of Limitations in the Superfund Amendments of 1986 Does Not Preempt Indiana's Statute of Repose in an Asbestos Worker's Action Against His Former Employer's Asbestos Supplier*

Section 309(a)(1) of the Superfund Amendments and Reauthorization Act of 1986<sup>169</sup> (SARA) amended the Comprehensive Environmental Response, Compensation, and Liability Act of 1980<sup>170</sup> (CERCLA) to add a federal exception to some state statutes of limitations.

In the case of any action brought under State law for personal injury, or property damages, which are caused or contributed to by exposure to any hazardous substance, or pollutant or contaminant, released into the environment from a facility, if the applicable limitations period for such action (as specified in the State statute of limitations or under common law) provides a commencement date which is earlier than the federally required commencement date, such period shall commence at the federally required commencement date in lieu of the date specified in such State statute.<sup>171</sup>

The "federally required commencement date" is "the date the plaintiff knew (or reasonably should have known) that the personal injury or property damages . . . were caused or contributed to by the hazardous substance or pollutant or contaminant concerned."<sup>172</sup>

In the district court, the plaintiffs in *Covalt* and *Knox* argued that SARA preempted Indiana's products liability statute of repose.<sup>173</sup> The *Knox* court held that SARA did not preempt the statute in a wrongful death action brought by the wife of a deceased asbestos worker against asbestos manufacturers.<sup>174</sup> Because, in the district court, the *Covalt* court held that the statute of repose did not preclude plaintiffs' similar action,

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168. *Covalt v. Carey Canada, Inc.*, 860 F.2d 1434, 1441 (7th Cir. 1988).

169. Pub. L. No. 99-499, 100 Stat. 1615 (codified as amended at 42 U.S.C.A. §§ 9601-9675 (West Supp. 1988)).

170. Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended at 42 U.S.C.A. §§ 9601-9675 (West Supp. 1988)).

171. 42 U.S.C. § 9658(a)(1) (Supp. IV 1986).

172. *Id.* at § 9658(b)(4)(A).

173. IND. CODE § 33-1-1.5-5 (1988).

174. *Knox v. AC & S, Inc.*, 690 F. Supp. 752, 754-58 (S.D. Ind. 1988).

the court did not reach the preemption issue.<sup>175</sup> The court did certify an interlocutory appeal to the Seventh Circuit.

In *Covalt v. Carey Canada, Inc.*,<sup>176</sup> the Seventh Circuit held that SARA did not preempt the statute of repose in an asbestos worker's action against the manufacturers that supplied raw asbestos to the plaintiff's former employer.<sup>177</sup> The court reasoned that neither SARA nor CERCLA applied to the claim because, "[a]sbestos encountered at work is not a toxic waste, and the Superfund Act is about inactive hazardous waste sites."<sup>178</sup>

The Seventh Circuit relied heavily on legislative reports.<sup>179</sup> These reports indicate that CERCLA focuses on "abandoned and inactive hazardous waste disposal sites."<sup>180</sup> Other reports indicate that "SARA . . . does not change the focus or structure of CERCLA."<sup>181</sup> The court therefore concluded:

The Superfund Act regulates waste dumps and other leakages "into the environment". The interior of a place of employment is not "the environment" for purposes of CERCLA—at least to the extent employees are the injured persons—and 309(a)(1) therefore does not apply to Covalt's claim. Covalt could not have taken advantage of 309(a)(1) had he developed asbestosis while on the job, and there is no reason why the statute should apply to him because he quit before becoming ill and sued Carey

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175. *Covalt v. Carey-Canada, Inc.*, 672 F. Supp. 367, 368 (S.D. Ind. 1987), *question certified to Indiana Supreme Court*, 860 F.2d 1434 (7th Cir. 1988).

176. 860 F.2d 1434 (7th Cir. 1988).

177. *Id.* at 1436.

178. *Id.* at 1437.

179. *Id.* at 1437-38. In particular the court relied on a Senate Committee on Environment and Public Works report: SUPERFUND SECTION 301(E) STUDY GROUP, 97TH CONG., 2D SESS., INJURIES AND DAMAGES FROM HAZARDOUS WASTES—ANALYSIS AND IMPROVEMENT OF LEGAL REMEDIES: A REPORT TO CONGRESS IN COMPLIANCE WITH SECTION 301(E) OF THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT OF 1980 (P.L. 96-510) (Comm. Print 1982) [hereinafter *Section 301(e) Study*]. *Covalt*, 860 F.2d at 1438. That report indicates that actions such as the one in *Covalt* are excluded from CERCLA:

Instances when hazardous substances may be released in other than waste form . . . are expressly exempted from the enforcement provisions of the Act. Thus, the emphasis of this report, similar to the emphasis of CERCLA, is on remedying the adverse consequences of improper disposal, improper transportation, spills, and improperly maintained or closed disposal sites.

*Section 301(e) Study*, *supra*, at 41, *quoted in Covalt*, 860 F.2d at 1438.

180. H. REP. NO. 9,601,016, 96th Cong., 2d Sess. 22, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 6119, 6125, *quoted in Covalt*, 860 F.2d at 1437.

181. *Covalt*, 860 F.2d at 1437.



Canada instead of [his former employer] Proko. The Superfund Act does not preempt Indiana's statute of repose.<sup>182</sup>

*H. The Statute of Repose Does Not Limit a Manufacturer's Liability if Some, But Not All, of Plaintiff's Injuries Occurred Within the Repose Period*

In *McDowell v. Johns-Manville Sales Corp.*<sup>183</sup> and a companion case decided the same day, *Groce v. Johns-Manville Sales Corp.*,<sup>184</sup> the court held that a plaintiff could recover for harm that occurred outside the repose period if some of plaintiff's injuries occurred within the repose period.<sup>185</sup>

In *McDowell* and *Groce*, plaintiffs had worked with asbestos from 1966 to 1975 and from 1959 to 1974 respectively. The defendant had delivered no asbestos to plaintiff's employer after 1976. In *McDowell*, doctors diagnosed plaintiff's asbestos related disease in June of 1980, and in *Groce* the diagnosis was made on February 15, 1980. Each plaintiff filed negligence and strict liability claims within two years after the diagnosis.<sup>186</sup>

In each case, defendant moved for summary judgment and argued that "to the extent plaintiff's claims are based upon exposure to asbestos delivered by [defendant] to plaintiff's employer more than ten years before this action was commenced, [defendant] is entitled to judgment on those claims."<sup>187</sup> Defendant argued that plaintiffs could only recover damages for harm that was caused by exposure to asbestos within the ten-year repose period.

The court denied summary judgment in both cases:

[Defendant's] attempt to divide liability finds no support in the case law and this argument has been rejected by other courts. The court finds that [plaintiff's] claim is timely under IND. CODE 33-1-1.5-5 in that [defendant] last delivered asbestos to her employer in 1976 which falls within the ten-year cutoff date.<sup>188</sup>

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182. *Id.* at 1439.

183. 662 F. Supp. 934 (S.D. Ind. 1987).

184. 662 F. Supp. 936 (S.D. Ind. 1987).

185. *McDowell*, 662 F. Supp. at 936; *Groce*, 662 F. Supp. at 938.

186. *McDowell*, 662 F. Supp. at 935; *Groce*, 662 F. Supp. at 937.

187. *McDowell*, 662 F. Supp. at 936; *see also Groce*, 662 F. Supp. at 937.

188. *McDowell*, 662 F. Supp. at 936 (citations omitted); *see also Groce*, 662 F. Supp. at 938. The court relied on two unpublished opinions: *Troxell v. Johns-Manville Sales Corp.*, No. 81-C-307 (S.D. Ind. Oct. 7, 1986) and *Thurston v. Johns-Manville Sales Corp.*, No. 81-C-243 (S.D. Ind. Sept. 5, 1986).

Consequently, if the allegedly defective product is one that causes "a disease which may have been contracted as a result of protracted exposure to a foreign substance,"<sup>189</sup> and if plaintiff was exposed to the product within the repose period, then plaintiff may recover damages for the harm caused by exposure to the product even if some of the exposure and some of the harm occurred outside the repose period.<sup>190</sup>

### *I. The Government Contractor Defense*

In *Boyle v. United Technologies Corp.*,<sup>191</sup> the United States Supreme Court held that federal law pre-empts state tort actions against federal military contractors in some instances and held:

Liability for design defects in military equipment cannot be imposed, pursuant to state law, when (1) the United States approved reasonably precise specifications; (2) the equipment conformed to those specifications; and (3) the supplier warned the United States about the dangers in the use of the equipment that were known to the supplier but not to the United States.<sup>192</sup>

In *Boyle*, a Marine helicopter pilot was killed when his helicopter crashed into the waters off the coast of Virginia. He survived the crash but drowned because he was unable to escape from the helicopter. The pilot's father brought a diversity action against the helicopter manufacturer. He alleged that the defendant improperly repaired the helicopter's automatic flight control system and that the defendant had designed the escape hatch defectively. For example, plaintiff alleged that the escape hatch was designed improperly to open out of, instead of into, the helicopter. Consequently, the water pressure on the submerged helicopter prevented the hatch from opening.<sup>193</sup>

The Fourth Circuit Court of Appeals reversed a jury verdict in favor of the plaintiff and held, among other things, that liability for the allegedly defective design of the escape hatch was barred as a matter

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189. *McDowell*, 662 F. Supp. at 935; see also *Groce*, 662 F. Supp. at 937.

190. The statute of repose does not deal with this issue; it merely limits the time in which a plaintiff must commence an action. IND. CODE § 33-1-1.5-5 (1988). If *McDowell* and *Groce* are read together with *Covalt v. Carey-Canada, Inc.*, 672 F. Supp. 367 (S.D. Ind. 1987), then a plaintiff may commence an action against, for example, an asbestos manufacturer more than 12 years after he was last exposed to the asbestos and also recover damages for exposure to the asbestos that occurs several years before that. If so, the statute of repose does not provide the safe harbor that it appeared to provide for manufacturers of products that cause latent disease after prolonged exposure.

191. 108 S. Ct. 2510 (1988).

192. *Id.* at 2518.

193. *Id.* at 2513.



of federal law because the defendant was a military contractor.<sup>194</sup> The Supreme Court granted certiorari.<sup>195</sup>

1. *The Pre-Emption Issue.*—The Court determined that *Boyle* presented facts that affected uniquely federal interests and that the conflict between the federal interests and state law was substantial enough to declare that federal law pre-empted state law even though there was no legislation granting immunity to government contractors.<sup>196</sup>

In most fields of activity, to be sure, this Court has refused to find federal pre-emption of state law in the absence of either a clear statutory prescription or a direct conflict between federal and state law. But we have held that a few areas, involving “uniquely federal interests” are so committed by the Constitution and laws of the United States to federal control that state law is pre-empted and replaced, where necessary, by federal law of a content prescribed (absent explicit statutory directive) by the courts—so-called “federal common law.”

The dispute in the present case borders upon two areas that we have found to involve such “uniquely federal interests.”<sup>197</sup>

Those areas are (a) federal obligations and rights under contracts and (b) the civil liability of federal officials for acts committed in the course of their duties.<sup>198</sup> The Court found that the first area was significant even though “[t]he present case does not involve an obligation to the United States under its contract, but rather liability to third persons,”<sup>199</sup> and found that even though “[t]hat liability may be styled one in tort, . . . it arises out of performance of the contract.”<sup>200</sup> The Court found that the second area was significant even though “[t]he present case involves an independent contractor performing its obligation under a procurement contract, rather than an official performing his duty as a federal employee.”<sup>201</sup>

We think the reasons for considering these closely related areas to be of “uniquely federal” interest apply as well to the civil liabilities arising out of the performance of federal procurement contracts. . . .

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194. *Boyle v. United Technologies Corp.*, 792 F.2d 413, 414-15 (4th Cir. 1986), *vacated*, 108 S. Ct. 2510 (1988).

195. 479 U.S. 1029 (1986).

196. 108 S. Ct. at 2513-16.

197. *Id.* at 2513-14 (citations omitted).

198. *Id.* at 2514.

199. *Id.*

200. *Id.*

201. *Id.*

Moreover, it is plain that the Federal Government's interest in the procurement of equipment is implicated by suits such as the present one—even though the dispute is between private parties. . . . The imposition of liability on Government contractors will directly affect the terms of Government contracts: either the contractor will decline to manufacture the design specified by the Government, or it will raise its price. Either way, the interests of the United States will be directly affected.<sup>202</sup>

The Court also determined that the conflict between the federal interests and state law was significant enough to require pre-emption of state law.

Here the state-imposed duty of care that is the asserted basis of the contractor's liability (specifically, the duty to equip helicopters with the sort of escape-hatch mechanism petitioner claims was necessary) is precisely contrary to the duty imposed by the Government contract (the duty to manufacture and deliver helicopters with the sort of escape-hatch mechanism shown by the specifications).<sup>203</sup>

2. *The Boyle Federal Common Law Rule.*—Having decided that federal law pre-empted state law, the Court then had to determine the applicable federal law.

The Fourth Circuit had reasoned by analogy from the rule of *Feres v. United States*,<sup>204</sup> which held that the Federal Tort Claims Act does not cover injuries that members of the military receive in the course of military service. In a companion case to *Boyle*, the Fourth Circuit stated that if military contractors are liable, they will pass the cost of this liability on to the government and “[s]uch pass-through costs would, of course, defeat the purpose of the immunity for military accidents conferred upon the government itself.”<sup>205</sup> The Supreme Court rejected this rationale because “the *Feres* doctrine, in its application to the present problem, logically produces results that are in some respects too broad and in some respects too narrow.”<sup>206</sup> The rule is too broad because it would grant immunity to a government contractor even if the product that caused the injury was purchased from stock and had a particular design feature in which the government had no significant interest.<sup>207</sup>

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202. *Id.* at 2514-15 (citations omitted).

203. *Id.* at 2516.

204. 340 U.S. 135, 146 (1950).

205. *Tozer v. LTV Corp.*, 792 F.2d 403, 408 (4th Cir. 1986), *cert. denied*, 108 S.Ct. 2897 (1988).

206. 108 S. Ct. at 2517.

207. *Id.*



The rule is too narrow because *Feres* applies only to injuries to persons in the military and "it could not be invoked to prevent, for example, a civilian's suit against the manufacturer of fighter planes, based on a state tort theory, claiming harm from what is alleged to be needlessly high levels of noise produced by the jet engines."<sup>208</sup>

Instead of relying on *Feres*, the Court reasoned by analogy from the provision in the Federal Tort Claims Act that precludes suits against the government "based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty."<sup>209</sup>

We think that the selection of the appropriate design for military equipment to be used by our Armed Forces is assuredly a discretionary function within the meaning of this provision. It often involves not merely engineering analysis but judgment as to the balancing of many technical, military, and even social considerations, including specifically the trade-off between greater safety and greater combat effectiveness. And we are further of the view that permitting "second-guessing" of these judgments through state tort suits against contractors would produce the same effect sought to be avoided by the FTCA exemption. The financial burden of judgments against the contractors would ultimately be passed through, substantially if not totally, to the United States itself, since defense contractors will predictably raise their prices to cover, or to insure against, contingent liability for the Government-ordered designs. To put the point differently: It makes little sense to insulate the Government against financial liability for the judgment that a particular feature of military equipment is necessary when the Government produces the equipment itself, but not when it contracts for the production. In sum, we are of the view that state law which holds Government contractors liable for design defects in military equipment does in some circumstances present a "significant conflict" with federal policy and must be displaced.

Liability for design defects in military equipment cannot be imposed, pursuant to state law, when (1) the United States approved reasonably precise specifications; (2) the equipment conformed to those specifications; and (3) the supplier warned the United States about the dangers in the use of the equipment that were known to the supplier but not to the United States. The first two of these conditions assure that the suit is within the area where the policy of the "discretionary function" would

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208. *Id.*

209. *Id.* (quoting 28 U.S.C. § 2680(a) (1982)).

be frustrated—*i.e.*, they assure that the design feature in question was considered by a Government officer, and not merely by the contractor itself. The third condition is necessary because, in its absence, the displacement of state tort law would create some incentive for the manufacturer to withhold knowledge of risks, since conveying that knowledge might disrupt the contract but withholding it would produce no liability.<sup>210</sup>

3. *Effect on Indiana Products Liability Law.*—If *Boyle* applies only to military equipment, then it will have only a limited direct effect on Indiana's products liability law. On the other hand, if, as the dissent fears,<sup>211</sup> the contractor's defense applies to products other than military equipment, then it will have more far-reaching effects. The government may specify and purchase virtually any product, and the discretionary function rationale applies as well to escape exits in government buildings as it does to escape hatches in government helicopters. In *Boyle*, the Court assumed an activist's role and approved the contractor's defense even though Congress has been silent on the issue<sup>212</sup> and even though the issues in *Boyle* merely bordered upon uniquely federal interests.<sup>213</sup> Consequently, firms that supply non-military equipment to the government have reason to expect that the Court will extend *Boyle* to their products. In addition, *Boyle's* rationale may apply by analogy to Indiana's discretionary functions provision.<sup>214</sup> If so, *Boyle's* scope may indeed be "breathhtakingly sweeping."<sup>215</sup>

### III. CONCLUSION

Both the statute of repose provision<sup>216</sup> and the "open and obvious danger" rule<sup>217</sup> continued to produce significant litigation as parties explored subtle distinctions or asked the courts to consider new and difficult situations. Although *Greeson*<sup>218</sup> will certainly change the outcome

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210. *Id.* at 2517-18 (citations and footnotes omitted).

211. *Id.* at 2520 (Brennan, J., dissenting) ("the Court's newly discovered Government contractor defense . . . applies not only to military equipment . . . but (so far as I can tell) to any made-to-order gadget that the Federal Government might purchase after previewing plans—from NASA's Challenger space shuttle to the Postal Service's old mail cars").

212. The dissent wrote that Congress had been "conspicuously" silent, "having resisted a sustained campaign by Government contractors to legislate for them some defense." *Id.* at 2519-20 (Brennan, J., dissenting).

213. 108 S. Ct. at 2514.

214. IND. CODE § 34-4-16.5-3(6) (1988).

215. *See Boyle*, 108 S. Ct. at 2520 (Brennan, J., dissenting).

216. *See supra* text accompanying notes 137-90.

217. *See supra* text accompanying notes 53-63, 90-110.

218. *See supra* text accompanying notes 6-36.



of some products liability actions and *Boyle*<sup>219</sup> will certainly effect at least a limited class of cases, the impact of the other cases discussed in this Article is not certain. Many of the cases raised as many questions as they answered, such as, whether the statute of repose is a "discovery" statute<sup>220</sup> and whether the "government contractor's defense" will apply to non-military contractors or to state government contracts.<sup>221</sup> Federal courts continued to influence Indiana's products liability law because litigants continued to ask them to decide important questions about Indiana law. As *Boyle* shows, federal courts can influence Indiana's products liability law in other ways as well.

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219. See *supra* text accompanying notes 191-215.

220. See *supra* text accompanying notes 137-68.

221. See *supra* text accompanying notes 204-10.

# Frivolous, Unreasonable or Groundless Litigation: What Shall the Standard Be for Awarding Attorney's Fees?

DONALD CLEMENTSON-MOHR\*

JEFFREY A. COOKE\*\*

## I. INTRODUCTION

Indiana Code section 34-1-32-1(b) gives a trial court the discretion to award attorney's fees as costs to the prevailing party if the opposing party:

- (1) brought the action or defense on a claim or defense that is frivolous, unreasonable, or groundless;
- (2) continued to litigate the action or defense after the party's claim clearly became frivolous, unreasonable, or groundless; or
- (3) litigated the action in bad faith.<sup>1</sup>

The costs statute was amended in March of 1986 to reflect the foregoing language, but as yet there are no appellate opinions construing the amendment.<sup>2</sup> However, a case was decided in the survey period<sup>3</sup> which applied the obdurate behavior, or "bad faith," exception to the "American Rule," which reflects the judicial policy generally disfavoring awards of attorney's fees. That case had implications for the construction of subsection (b)(3) and will be discussed here from that standpoint with particular interest paid to continuing tensions in Indiana Law concerning the parameters of the general equitable power of the courts to award attorney's fees as sanctions.

Also, a significant trilogy of opinions concerning the award of attorney's fees on appeal, pursuant to Appellate Rule 15(G), were issued in tandem by the Supreme Court during the survey year.<sup>4</sup> The standards

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\* Attorney at Law, private practice in Lafayette, Indiana. A.B., University of Texas, 1972; J.D., Indiana University School of Law—Indianapolis, 1984.

\*\* Partner, Cooke Bache Laszynski & Moore, Lafayette, Indiana. B.A., Purdue, 1967; J.D., University of Connecticut, 1970.

1. IND. CODE § 34-1-32-1(b) (1988).

2. An excellent overview of the statute and its relationship to the obdurate exception to the American rule can be found in Hull, *Attorney's Fees for Frivolous, Unreasonable or Groundless Litigation*, 20 IND. L. REV. 151 (1987). Wherever possible, this Article will avoid overlap with that review.

3. *Maggio v. Lee*, 511 N.E.2d 1084 (Ind. Ct. App. 1987).

4. *Orr v. Turco Mfg. Co.*, 512 N.E.2d 151 (Ind. 1987); *Posey v. Lafayette Bank & Trust Co.*, 512 N.E.2d 155 (Ind. 1987); *Leshner v. Baltimore Football Club*, 512 N.E.2d 156 (Ind. 1987).



developed in those cases for evaluating attorney's fees awards as sanctions for bringing a meritless appeal will be discussed as having predictive power for future constructions of subsections (b)(1) and (b)(2) of the statute. The legal standards of these cases will also be evaluated in terms of the legislative policies that appear to underlie the amendment of the statute.

## II. BAD FAITH LITIGATION

It has been suggested that subsection (b)(3) of the statute<sup>5</sup> is likely to be construed by the courts as a "codification" of the obdurate behavior exception to the American Rule.<sup>6</sup> There is some value to that view. It is almost unquestionably correct that interpretive standards developed in that common law context will inform construction of the statute. Bad faith is *the* "essential element in triggering the award of attorney fees"<sup>7</sup> under the equitable exception. Obviously, this is true of (b)(3) as well; bad faith is the core concept. It is also true that (b)(3), like the obdurate behavior exception, is relatively narrow in scope in that the statute expressly applies only to the conduct of litigation, and not to pre-litigation behavior, even conduct that makes litigation a virtual necessity.<sup>8</sup>

However, to view subsection (b)(3) as a "codification" of the obdurate behavior exception is perhaps an overly strong description of the relationship. There are two aspects of the new statute that make the statute a much broader exception to the American Rule than the obdurate behavior rule. First, the statutory language specifically applies both to defendants as well as to plaintiffs. This is an important innovation. In *Kikkert v. Krumm*,<sup>9</sup> the Supreme Court held that the obdurate exception provides a remedy only "for defendants who are dragged into baseless litigation."<sup>10</sup>

*Kikkert* dramatically reduced the potential scope of the obdurate behavior rule, particularly in comparison with the broad perspective of *St. Joseph College v. Morrison, Inc.*,<sup>11</sup> where the exception to the American rule was first announced by the Indiana Court of Appeals. The court in *St. Joseph College* took the view that when a "party's" conduct was vexatious and oppressive in the extreme, equity might compel an award of attorney's fees.<sup>12</sup> In that case, the plaintiff was denied

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5. IND. CODE § 34-1-32-1 (1988).

6. See Hull, *supra* note 2, at 154-55.

7. State v. Hicks, 465 N.E.2d 1146, 1149 (Ind. Ct. App. 1984).

8. See Kikkert v. Krumm, 474 N.E.2d 503, 505 (Ind. 1985).

9. 474 N.E.2d 503 (Ind. 1985).

10. *Id.* at 505.

11. 158 Ind. App. 272, 279-80, 302 N.E.2d 865, 870 (1973).

12. *Id.*

attorney's fees, not because of his plaintiff status, but because the mechanics' lien attorney's fee statute did not apply, and because the defendant's conduct did not constitute bad faith.<sup>13</sup> No policy justification was offered in *Kikkert* in making the bad faith of defendants less sanctionable with attorney's fees than the bad faith of plaintiffs.<sup>14</sup> A defendant who conducts his defense maliciously would appear to be abusing the legal system no less than a plaintiff who initiates the action with the same motivation.

Second, subsection (b)(3) also differs from the obdurate behavior rule in that the statute would appear to apply to any bad faith litigation practice, at *any* point in a suit. This is also a significant change in the availability of attorney's fees sanctions. The application of the *Kikkert* rule was limited to the time of the bringing of a baseless claim, or the time that a party discovers that a claim is baseless and fails to dismiss it.<sup>15</sup> A case decided during the survey period is illustrative of these limitations of the *Kikkert* rule, and raises some related issues that remain unresolved.

In *Maggio v. Lee*,<sup>16</sup> the defendant sought, and was awarded by the trial court, a prospective award of attorney's fees because of a continuance sought by the plaintiff. The trial court's award was based on Trial Rule 53.5, which allows an award for actual expenses incurred from delay by an opposing party.<sup>17</sup> The Court of Appeals reversed, holding that Trial Rule 53.5 does not apply to awards of attorney's fees as costs. It was further noted that the decision could not be upheld under the obdurate behavior exception because the rule "clearly" did not apply to the circumstances of that case.

The court of appeals did not specify the factual basis for their decision in *Maggio*, but, if nothing else, the obdurate behavior exception could not come into play in that case because the plaintiff's seeking of the continuance was not a matter of filing or failing to dismiss a "knowingly baseless claim" as required by *Kikkert*.<sup>18</sup> The same result was not required by the statute. If a party's delay results in added attorney's fees for the other party, and the delay is a result of that party's litigating the action in bad faith, then an award of attorney's fees would seem to be mandated by subsection (b)(3), unlike the "equitable" rule. If the plaintiff's motion for a continuance in *Maggio* was

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13. *Id.*

14. 474 N.E.2d 503 (Ind. 1985).

15. *Id.*

16. 511 N.E.2d 1084 (Ind. Ct. App. 1987).

17. IND. R. TR. P. 53.5.

18. 474 N.E.2d 503 (Ind. 1985).



sought in bad faith, then an award of attorney's fees to the defendant was at least possible.

This legislative decision to make all bad faith litigation conduct liable for an award of attorney's fees appears eminently sensical. No litigant should be forced to endure the slings and arrows of outrageous litigation practices without compensation for the economic costs of dealing with them. There is no justification for allowing bad faith conduct in litigation to result in an added attorney's fees burden to the other party at *any* stage of litigation.

This is not to say that (b)(3) is an absolute paragon of logical consistency. Assume that the defendant in *Maggio* had been able to prove that he was indeed prejudiced by the plaintiff's delay, and that the plaintiff's seeking of the continuance was in bad faith. As under the *Kikkert* rule, an award under the statute would be permissible *only* if the defendant was the "prevailing party."<sup>19</sup> It is difficult to justify a failure to award attorney's fees solely because the "victim" of the bad faith does not prevail in the action. Like the obdurate behavior exception, the statute is founded on a model that bad guys never win.

It might seem a more rational approach to focus on the core concept of both subsection (b)(3) and the equitable exception—bad faith—as the *sole* basis for determining the award of attorney's fees in all cases. Language quoted in *St. Joseph College v. Morrison, Inc.*<sup>20</sup> suggests that awarding attorney's fees as a sanction against bad faith conduct by a litigant is well within the inherent powers of a court: "The *power* to grant attorney's fees springs from the equitable powers of the court."<sup>21</sup> Though a court's inherent power to award attorney's fees is normally described as limited to the prevailing party,<sup>22</sup> this view appears to be utterly inconsistent with the equitable basis for the rule.

Consistent with the latter view, Judge Sullivan expressed dissatisfaction with the limitations of the *Kikkert* rule in his concurrence in *Maggio*:

In any event, notwithstanding the "American Rule" and notwithstanding specific inclusion in other trial rules of attorney fees as recoverable, I am of the view that the courts have the inherent authority to award attorney fees where necessary to compensate a litigant who has been unduly burdened or prejudiced.<sup>23</sup>

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19. *Id.*

20. 158 Ind. App. 272, 302 N.E.2d 865 (1973).

21. *Id.* at 279, 302 N.E.2d at 870 (quoting *La Raza Unieta v. Volpe*, 57 F.R.D. 94 (N.D. Cal. 1972)).

22. *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 257-59 (1975).

23. 511 N.E.2d at 1086 (Sullivan, J., concurring).

Whatever the outer limits of the *power* of an Indiana court to award attorney's fees, because the new statutory language encompasses and expands the *Kikkert* common-law rule, it appears unlikely that Indiana courts will move far afield from the wording of the statute with expansive exercises of their equitable powers.

Future construction of the new statutory language may, to the degree that its language permits, continue the judicial policy of severely limiting awards of attorney's fees. The language selected by the amendments passed by the Indiana Legislature appear to point in an opposite public policy direction. In light of: (1) the well-established parameters of the obdurate behavior exception as propounded in *Kikkert*, and (2) the changes in the law effected by the statute, it would be difficult to argue that the amendments do not express a policy interest in widening the scope of valid awards of attorney's fees, both for bad faith and, as discussed below, baseless litigation. Had the legislature been satisfied with the *Kikkert* rule then there would have been no need for the statute. It would appear that a policy decision has been made that the courts should be less constrained in their awards of attorney's fees. Whether the courts will choose to enforce that policy when construing the statute is unclear.

### III. FRIVOLOUS, UNREASONABLE, OR GROUNDLESS LITIGATION

Unlike subsection (b)(3), application of the subsections (b)(1) and (b)(2) of the statute do not require a showing of bad faith.<sup>24</sup> The statutory language of (b)(1) and (b)(2) appears to express a legislative intention to create an "objective" standard for an award of attorney's fees, which

shifts the court's inquiry from a search for the improper motives of the losing party to a review of the legal and factual basis of the losing party's claim or defense. This inquiry into whether a party "brought the action or defense" or "continued to litigate the action or defense after the party's claim or defense clearly became frivolous, unreasonable or groundless," is both a legal and factual inquiry that goes to the very merits of a claim or defense. The subsections place an obligation on litigants to investigate the legal and factual basis of the claim when filing and to continuously evaluate the merits of claims and defense as asserted throughout litigation.<sup>25</sup>

It could not be reasonably disputed, given the explicit requirement of bad faith in (b)(3) and the absence of the same requirement in (b)(1)

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24. IND. CODE § 34-1-32-1 (1988).

25. Hull, *supra* note 2, at 156.



and (b)(2), that a finding of bad faith is *irrelevant* as a *necessary* element to an appropriate application of subsections (b)(1) and (b)(2). The problem facing Indiana courts now is determining an appropriate legal standard with which to construe the language of those subsections. "Frivolous, unreasonable, or groundless" are not self-defining terms. Legal standards will have to be formulated by the courts. If it is true that the intention of the legislature was to stake out a policy favoring an award of attorney's fees when a party is burdened by litigation that is without legal or factual foundation, then it is a matter of some interest whether the courts will engraft a "strict standard" based on the *Kikkert*<sup>26</sup> rule onto this language. The standard employed by Indiana appellate courts to determine if a statutory award of attorney's fees is justified under (b)(1) and (b)(2) can either effectuate the policy goals of the statute or eviscerate them.

The position to be developed here is that the Indiana Supreme Court has already sent such a signal with the recent "trilogy" of opinions which will be discussed next in this Article. Although the three cases were specifically addressed to application of Appellate Rule 15(G),<sup>27</sup> they will be shown to have clear implications for future interpretation of subsections (b)(1) and (b)(2).

#### A. *Orr v. Turco Manufacturing Co.*<sup>28</sup>

In *Orr*, the plaintiff filed a products liability suit on behalf of her minor daughter. The defendant moved for summary judgment based on the statutory two-year limitations period. Defendant's motion was granted.<sup>29</sup> The plaintiff appealed, attacking both the applicability of the statute of limitations to a minor and the constitutionality of the statute. The judgment was affirmed by the court of appeals, but the court did not address the defendant's motion for attorney's fees pursuant to Appellate Rule 15(G). Transfer was denied, and thereafter the court of appeals granted the motion for attorney's fees in a second opinion.<sup>30</sup>

The rationale of the court of appeals for the attorney's fees award was that the challenge to the statute was "frivolous because wholly without merit, and, thus, presumptively taken in bad faith."<sup>31</sup> This perspective turned on: (1) the absolute clarity of the statutory language

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26. *Kikkert v. Krumm*, 474 N.E.2d 503 (Ind. 1985).

27. IND. R. APP. P. 15(G).

28. 512 N.E.2d 151 (Ind. 1987).

29. *Id.* at 152.

30. *Orr v. Turco Mfg. Co.*, 496 N.E.2d 115 (Ind. Ct. App. 1986), *vacated*, 512 N.E.2d 151 (Ind. 1987).

31. *Id.* at 118.

as to minority status, and (2) the failure of the plaintiff to distinguish ruling precedents of the Indiana Supreme Court which upheld the constitutionality of the statute. The court of appeals expressly recognized the potential problems with such an award, such as chilling appellate review, but it held that an appellate brief must contain some reasoned argument that raises at least a "faint glimmer of hope" that the appeal will be successful.<sup>32</sup> Otherwise, it was held, sanctions should be imposed. Sanctions in *Orr* were deemed appropriate by the court of appeals because:

To bring such an issue on appeal goes beyond mere speciousness and amounts to bad faith. To be specious, the issue must at least appear on its face to have some merit. This "issue" does not even have the slightest appearance of merit. It is totally and absolutely meritless.<sup>33</sup>

The Indiana Supreme Court granted transfer and reversed as to the motion for attorney's fees.<sup>34</sup> The court expressed concern that such sanctions might deter the proper exercise of a lawyer's responsibility to argue for modification or reversal of existing law and would also have a chilling effect upon the exercise of the right to appeal. Because such sanctions have the potential to "discourage innovation and inhibit the opportunity for periodic re-evaluation of controlling precedent,"<sup>35</sup> it was held that "punitive sanctions may not be imposed to punish lack of merit unless an appellant's contentions and argument are utterly devoid of all plausibility."<sup>36</sup>

Applying its announced test to the plaintiff's brief, the Indiana Supreme Court found, contrary to the view of the court of appeals, "concise cogent argument" in the plaintiff's brief which attempted to distinguish prior precedent.<sup>37</sup> It further noted citation of authority in support of plaintiff's argument that the trial court erred in excluding evidence of legislative history of the statute (an issue not addressed by the court of appeals in its opinion), and finally the court found:

no indication of bad faith, frivolity, harassment, vexatiousness, or purpose of delay. While the Court below found Appellant's contentions insufficient to prevail on appeal, we hold that Appellant presented plausible argument for clarification, modifi-

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32. *Id.*

33. *Id.*

34. *Orr v. Turco Mfg. Co.*, 512 N.E.2d 151, 153 (Ind. 1987).

35. *Id.* at 152.

36. *Id.* at 153.

37. *Id.*



cation or reversal of existing law. Punitive sanctions are not justified in this case.<sup>38</sup>

Regrettably, there were no quotations from the plaintiff's appellate brief to justify the Indiana Supreme Court's perceptions of the plaintiff's briefing. Such quotations would have been useful since the court's reversal turned on an evaluation of the plaintiff's brief that was entirely contrary to the perception strongly held by the court of appeals, that the plaintiff had not attempted to distinguish prior precedents.

### B. *Lesh v. Baltimore Football Club*<sup>39</sup>

The plaintiffs in *Lesh* were football fans who had sent orders for season tickets, accompanied by prepayment, to the new Indianapolis Colts. In light of the requirement of prepayment, the plaintiffs were disgruntled by the lottery system instituted by Colts' management to handle the situation that the number of requests for season tickets vastly outnumbered the number of tickets available for that purpose. The plaintiffs sued the Colts on several theories.

The trial court granted summary judgment and the court of appeals affirmed, ordering the plaintiffs to pay the defendant's attorney's fees because the plaintiffs' contentions were without merit. As in *Orr*, the court of appeals indicated in *Lesh* that its decision took into account the strict standard for such an award, but was nevertheless convinced that an award was appropriate, expressing its annoyance "at having to devote our time and energy to an absolutely meritless claim for unnegotiated interest."<sup>40</sup>

The Indiana Supreme Court granted transfer and reversed as to the attorney's fees, based on the standard of *Orr*, because "there was no indication that the court found bad faith, frivolity, harassment, vexatiousness or purpose of delay. To the contrary, the appeal was expeditiously presented, the record and briefs were concise, and the issues were addressed with plausible argument."<sup>41</sup>

### C. *Posey v. Lafayette Bank and Trust Company*<sup>42</sup>

In *Posey*, the plaintiff sought appellate review of the trial court's decision terminating a decedent's guardianship and approving the guar-

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38. *Id.*

39. 512 N.E.2d 156 (Ind. 1987).

40. *Id.* at 157 (quoting *Lesh v. Baltimore Football Club*, 496 N.E.2d 785, 793 (Ind. Ct. App. 1986)).

41. 512 N.E.2d at 157.

42. 512 N.E.2d 155 (Ind. 1987).

dian's final report and various expenses and attorney's fees of the defendant law firms. There had been a prior interlocutory appeal of the trial court's orders naming the decedent's guardians, and the prior appeal involved many of the same issues as the later one. The court of appeals affirmed the trial court on the merits and awarded attorney's fees to the defendant because of the plaintiff's bad faith in (1) disregarding the form and content requirements of the Appellate Rules, (2) failing to disclose his previous appeal, which raised many of the same issues, (3) using factual omissions and misstatements of the record to raise his issue, and (4) writing his brief "in a manner calculated to require the maximum expenditure of time, both by [appellee] and by this court."<sup>43</sup>

Noting that it had reversed the court of appeals in *Orr* and *Leshner*, the Indiana Supreme Court granted transfer in *Posey* solely to address the attorney's fees issue "in order to provide guidance to the bench and bar as to the circumstances when such fees are appropriate."<sup>44</sup> The Supreme Court found the circumstances cited by the court of appeals to be:

significantly more grave than mere lack of merit. Gross abuse of the right to appellate review "crowds our court to the detriment of meritorious actions and should not go unrebuked." *Marshall v. Reeves* (1974) 262 Ind. 403, 404, 316 N.E.2d 288, 830 Ind.App. 297, 299, 89 N.E. 320).<sup>45</sup>

Even if the Indiana Supreme Court had not expressly noted that it was sending the bar "a message," the juxtaposition of the three cases certainly would have communicated the same intent. It would be difficult for the court to have indicated any more clearly that awards of attorney's fees for meritless appeals are disfavored unless there are objective indices of bad faith present as well. In both *Orr* and *Leshner*, the court explicitly noted the good craftsmanship of the briefing and the lack of a finding of bad faith. In *Posey*, just the opposite was the case. It appears that mere speciousness of legal theory will not suffice to support an award of attorney's fees pursuant to Appellate Rule 15(G).<sup>46</sup>

This policy likely has implications for how subsections (b)(1) and (b)(2)<sup>47</sup> are to be construed. The goal of providing an environment which affords change in the law, which informed the opinion in *Orr*, is equally

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43. *Id.* at 156 (quoting *Posey v. Lafayette Bank & Trust Co.*, 496 N.E.2d 1355 (Ind. App. Dist 1986) (unpublished memorandum opinion)).

44. *Id.* at 155.

45. *Id.* at 156 (quoting *Vandalia R.R. v. Walsh*, 44 Ind. App. 297, 299, 89 N.E. 320 (1909)).

46. IND. R. APP. P. 15(G).

47. IND. CODE §§ 34-1-32-1(b)(1), (2) (1988).



applicable to actions on the trial court level. Also, there is no forthright basis to distinguish the statutory language from the "meritless" terminology at issue in the *Orr* trilogy. Finally, in *Orr* the Indiana Supreme Court specifically noted the new statute in a footnote without comment.<sup>48</sup> A reasonable inference to be drawn from all of this is that trial court awards of attorney's fees under the statute, as with awards pursuant to Appellate Rule 15(G), will not be well-received on the appellate level if the sole basis of the award is that the claim or defense is "frivolous, unreasonable or groundless." It follows that, unless a future opinion states otherwise, the "utterly devoid of all plausibility" standard for reviewing the merit of appeals for an award under Appellate Rule 15(G) was intended to apply, at least implicitly, to awards of attorney's fees under subsections (b)(1) and (b)(2) as well. The question is, if that be true, whether the judicial policy of *Orr* is consistent with the legislative intent in enacting the new amendments to Indiana Code section 34-1-32-1(b).

The language of the *Orr* standard was selected over a strongly worded objection in the concurrence of Justice DeBruler, which was joined by Chief Justice Shephard.<sup>49</sup> Justice DeBruler pointed out that the burden on a party who must oppose a meritless appeal should properly contribute to the equation of whether to award appellate attorney's fees. Justice DeBruler argued forcefully that the choice of language by the majority cut too deeply against the equitable objectives of Appellate Rule 15(G) and suggested a preference for the term "arguable" as a legal test for a meritless appeal.<sup>50</sup>

An "arguable point is one which is subject to rational dispute and debate."<sup>51</sup> It was the perspective of Justice DeBruler that the language chosen by the majority too readily afforded "an argument without substance, but with a very superficial appearance of validity or even gloss of attractiveness, must be tolerated and will preclude an assessment of damages under the Rule."<sup>52</sup> It was Justice DeBruler's idea that it was unfair to deny attorney's fees to a litigant forced to pay for the cost of opposing arguments that merely have a gloss of validity. Chief Justice Shepard, in a separate concurring opinion, elaborated on this equitable theme:

The parties who appear in our courts do so on an equal footing. For every citizen who files a frivolous pleading, there is a citizen

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48. 512 N.E.2d 151 (Ind. 1987).

49. *Id.* (DeBruler, J., concurring).

50. *Orr v. Turco Mfg. Co.*, 512 N.E.2d 151, 154 (Ind. 1987) (citing *Anders v. California*, 386 U.S. 738, 744 (1967)).

51. *Id.*

52. *Id.*

who must spend money to respond. The threshold for frivolity should not be so low that it imposes a tax on responding parties, obligating them to spend money answering baseless claims as a way of encouraging others to be novel.<sup>53</sup>

Affirmative attempts to change the inequities caused by existing law, based on a perception that the law no longer has a sound social or economic foundation, are of obvious importance, even absolutely crucial, to the common-law legal system. The same cannot be said of claims that are merely "novel." The critiques of the *Orr* standard by Justice DeBruler and Chief Justice Shephard appear to be well taken. It has been suggested elsewhere that "whether or not a claim is frivolous . . . does not depend on its novelty before a specific court. Otherwise, any party raising an obscure but totally meritless argument for the first time in a court could be automatically shielded from paying attorneys' fees."<sup>54</sup> It should be noted in this context that Justice DeBruler concurred in *Orr* only because "the appeal before us is not utterly devoid of all plausibility, since this court had not previously addressed the question on the validity of this statute of limitation as it applies to children and incapacitated persons."<sup>55</sup>

*Orr* reflects a value that is almost beyond dispute; our legal system should seek to provide a high level of protection for a willingness to engage in corrective litigation. However, it can still be reasonably argued that a more moderate standard of review than that propounded by the Indiana Supreme Court, one that takes into account the equities of the parties who are *burdened* by meritless litigation, would have the capacity to protect the system equally as well. Many jurisdictions, which have statutory exceptions to the American rule when a claim or defense is "frivolous," have adopted the "reasonable lawyer test." The Wisconsin Supreme Court has indicated that the most appropriate level of inquiry to determine if an award of attorney's fees is appropriate is:

whether the attorney knew or should have known the position taken was frivolous as determined by what a *reasonable attorney* would have known or should have known under the same or similar circumstances . . . [which] does not require the highest level of competence or legal ability. It embraces "the objective standard of what a reasonable attorney would have done under the same or similar circumstances."<sup>56</sup>

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53. *Id.* (Shepard, C.J., concurring).

54. *Department of Revenue v. Arthur*, 153 Ariz. 1, 4, 734 P.2d 98, 101 (Ariz. Ct. App. 1986).

55. *Orr*, 512 N.E.2d at 155 (DeBruler, J., concurring).

56. *Radlein v. Industrial Fire & Casualty Ins. Co.*, 345 N.W.2d 874, 886 (Wis.



Interestingly, the Indiana Court of Appeals has applied such a standard for appellate review of judgments where the action was brought on a malicious prosecution theory.

We conclude that the objective standard which should govern the reasonableness of an attorney's action in instituting litigation for a client is whether the claim merits litigation. . . . The question is answered by determining that no competent and reasonable attorney familiar with the law of the forum would consider that the claim was worthy of litigation on the basis of the facts known by the attorney who instituted suit.<sup>57</sup>

The malicious prosecution case law was not even mentioned by the Indiana Supreme Court in *Orr*. This omission is difficult to understand, given the obvious conceptual link between the two areas of law. The "reasonable lawyer" standard is one that is easily understood and applied. It may not require the highly permissive standard of *Orr* to protect legitimate attempts to establish a new theory of law or good faith efforts to extend, modify, or reverse existing law. There is a point at which it should be clear to any lawyer that a given claim or defense should not be advanced at all. Whether a given claim or defense is "frivolous" under such a standard is not something that is utterly refractory to appellate review. In *Leshner*,<sup>58</sup> the Chief Justice appeared to be making a point when he observed in his dissent that:

Appellants' legal claims have been rejected unanimously by all three levels of Indiana's judiciary. Not a single judge has regarded even one argument as sufficiently worthwhile to survive summary judgment. Though losing a lawsuit hardly makes one's claims frivolous, I [will] mention just three of appellants' arguments to illustrate why the Court of Appeals order of fees should be allowed to stand.<sup>59</sup>

What followed was a somewhat scornful review of the arguments raised in *Leshner* by the plaintiff. The point Chief Justice Shephard seemed to be making is that the arguments were so lacking in objective merit on their face, if not "utterly devoid of all plausibility," that attorney's fees were appropriate.

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1984) (quoting *In re Estate of Bilsie*, 100 Wis. 2d 342, 350, 302 N.W.2d 508, 514 (Wis. Ct. App. 1981) (quoting *Sonsmer v. Carr*, 99 Wis. 2d 789, 797, 299 N.W.2d 856, 860 (1981))).

57. *Wong v. Tabor*, 422 N.E.2d 1279, 1288 (Ind. Ct. App. 1981).

58. *Leshner v. Baltimore Football Club*, 512 N.E.2d 156, 157 (Ind. 1987).

59. *Id.* (Shepard C.J., dissenting).

## IV. CONCLUSION

Developing a jurisprudence that would on the one hand afford forbearance of good faith attempts at changing the law, but on the other hand still award attorney's fees for "frivolous, unreasonable or groundless" litigation would be a difficult task. But that is not to say that such a jurisprudence represents an impossible goal. Other jurisdictions have proceeded as if their courts, both trial and appellate, can detect the difference between a ground-breaking lawsuit and one that is merely without merit.<sup>60</sup> Indiana courts can make the distinction as well.<sup>61</sup> To make the attempt would be consistent with the clear intent to liberalize awards of attorney's fees.

Consistent with Justice DeBruler's concerns, the difficulty with the "utterly devoid of all plausibility" test is that the standard may leave the door wide open, free of sanctions, to claims and defenses that *any* "reasonable attorney" would reject as "frivolous, groundless or unreasonable." That is, a clearly frivolous claim might always have *some* plausibility, albeit obscurely so, in the hands of a careful lawyer, who could avoid the appellate improprieties that figured in *Posey*. Our legal system is *not* enhanced by the toleration of genuinely meritless litigation, even when it is conducted with minimal competence, solely on the ground that the system requires a fearless bar, ready and willing to extend the law. If Indiana Code section 34-1-32-1(b) is construed in that fashion, then the clear intent of the legislature will be contravened.

The important issue is, of course, not the specific language chosen to effectuate a policy but rather, what judicial policy is being enforced? How tolerant must an Indiana trial court be of claims and defenses that appear *objectively* to be "frivolous, unreasonable or groundless" when there are no indices of bad faith in the litigation? The definitive answer is yet to come. Taken together, the Orr trilogy would seem to indicate that, absent *some* indicia of bad faith in litigation, seeking an award of attorney's fees, pursuant to subsection (b)(1) or (b)(2),<sup>62</sup> will be, at best, an uphill task.

Presumably, if bad faith can be shown, then the chances for attorney's fees for the bringing or maintaining of a frivolous claim or defense will be greatly enhanced. Even under the *Orr* standard, a pleading

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60. *Western United Realty, Inc. v. Isaacs*, 679 P.2d 1063, 1069 (Colo. 1984); *Radlien v. Indus. Fire & Casualty Ins. Co.*, 345 N.W.2d 874, 886 (Wis. 1984).

61. For example, in an opinion handed down during the survey period, but before *Orr*, the court of appeals declined to award attorney's fees pursuant to Appellate Rule 15(G) because of the lack of clarity in precedent. *Mack v. American Fletcher Nat'l Bank*, 510 N.E.2d 725, 741 n.14 (Ind. Ct. App. 1987).

62. IND. CODE § 34-1-32-1(b) (1988).



will perhaps not have to be "totally devoid of all plausibility" to justify an award if *some* showing of bad faith can be made. As a practical matter, after *Orr*, the standard for what constitutes "frivolous, unreasonable or groundless" may be so difficult to meet that a showing of bad faith may be required. Indiana attorneys must, therefore, be alert for frivolous claims and defenses and, when encountered, set about to create a "paper trail" (e.g., sending copies of controlling cases to the opposing attorney<sup>63</sup>) that will make the bad faith of such pleadings manifest to the trial judge and, as part of the record, also make an award of attorney's fees sustainable on appeal.

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63. See *American Mut. Liab. Ins. Co. v. Zion & Klein, P.A.*, 399 Pa. Super. 475, 478-79, 489 A.2d 259, 261 (1985).

# Professional Responsibility

MARTIN E. RISACHER\*

## I. INTRODUCTION

During the survey period,<sup>1</sup> the state and federal appellate courts decided a number of cases in the areas of Professional Responsibility and Professional Liability. This Article will discuss in detail several of the cases which significantly affect the Indiana practitioner, some of which address issues of first impression in Indiana. In the analysis of the cases selected for comment, particular attention will be given to the effect of the newly adopted Rules of Professional Conduct<sup>2</sup> upon the case whenever appropriate.

## II. ATTORNEY ADVERTISING

### A. Targeted Direct-Mail Solicitations: *Shapero v. Kentucky Bar Association*

The United States Supreme Court's decision in *Bates v. State Bar of Arizona*<sup>3</sup> and its progeny,<sup>4</sup> has fueled a great interest among the members of the practicing bar as to the extent of First Amendment protection afforded various forms of attorney advertising. In a long awaited decision, the United States Supreme Court in *Shapero V. Kentucky Bar Association*<sup>5</sup> concluded, in a 6-3 decision authored by Justice Brennan, that a state may not prohibit targeted, direct-mail solicitation absent a "particularized finding that the solicitation is false or misleading."<sup>6</sup>

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\* Associate, Church, Church, Hittle & Antrim, Noblesville, Indiana; B.A., Indiana State University (*magna cum laude*) 1972; J.D., Indiana University School of Law, 1975. The author wishes to express his appreciation for the assistance of Carolyn A. Bielefeld in the preparation of this Article.

1. This Article will report on all Indiana Supreme Court disciplinary cases decided during the survey period. Cases which do not raise significant issues or reflect changes in Indiana law will receive brief report in the final section of this Article.

2. Model Rules of Professional Conduct, adopted November 25, 1986, and effective January 1, 1987.

3. 433 U.S. 350 (1977).

4. *In re R.M.J.*, 455 U.S. 191 (1982) (held unconstitutional a Missouri Supreme Court rule which prohibited a lawyer from listing areas of practice in an advertisement); *In re Primus*, 436 U.S. 412 (1978); *Ohralik v. Ohio State Bar Ass'n*, 436 U.S. 447 (1978) (upheld Ohio's ban on in-person solicitation); *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626 (1985) (held unconstitutional an Ohio rule which forbade attorney's advertisements containing information or legal advice regarding a specific legal problem).

5. 108 S. Ct. 1916 (1988).

6. *Id.* at 1920.



The petitioner in *Shapero* was a Kentucky lawyer who sought approval from the appropriate agency of the Kentucky Bar Association<sup>7</sup> before sending the following letter to defendants in mortgage foreclosure actions:

It has come to my attention that your home is being foreclosed on. If this is true, you may be about to lose your home. Federal law may allow you to keep your home by ORDERING your creditor [sic] to STOP and give you more time to pay them. You may call my office anytime from 8:30 a.m. to 5:00 p.m. for FREE information on how you can keep your home. Call NOW, don't wait. It may surprise you what I may be able to do for you. Just call and tell me that you got this letter. Remember, it is FREE, there is NO charge for calling.<sup>8</sup>

After winding its way through the Kentucky Bar Association's lawyer advertising approval process,<sup>9</sup> the issue ultimately reached the Kentucky Supreme Court. The Kentucky Supreme Court, upon review of the bar association opinion concerning the letter, deleted its own rule which imposed a blanket prohibition upon the mailing or delivery of written advertisements "precipitated by a specific event or occurrence involving or relating to the addressee . . . as distinct from the general public."<sup>10</sup> However, the Kentucky Supreme Court replaced this Rule with Rule 7.3 of the American Bar Association's Model Rules of Professional Conduct which also prohibits targeted, direct-mail solicitation by lawyers.<sup>11</sup>

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7. Kentucky has a unified bar whereby all attorneys are required to belong to the Kentucky Bar Association as a condition of practice in the Commonwealth. The Kentucky Bar Association, in addition to the social and professional activities for attorneys, performs the function of lawyer discipline. It also staffs the Attorneys Advertising Committee which rules upon attorney advertising. Indiana has no system of prior approval of attorney advertising.

8. 108 S. Ct. at 1919.

9. The Kentucky Attorneys Advertising Commission did not find the letter false or misleading but found that the letter violated an existing Kentucky Supreme Court Rule. However, the commission also believed the rule violated the First Amendment and suggested the Kentucky Supreme Court amend its rules. Shapero then petitioned the Legal Ethics Committee of the Kentucky Bar Association for an advisory opinion as to the validity of the rule. The ethics committee agreed that the letter was not false or misleading but found that the Rule was consistent with Rule 7.3 of the American Bar Association's (ABA) Model Rules of Professional Conduct (1984). The Kentucky Supreme Court reviewed the decision of the Ethics Committee.

10. *Shapero v. Kentucky Bar Ass'n*, 108 S. Ct. 1916, 1920 n.2 (1988).

11. The Supreme Court indicated its puzzlement with the Kentucky Supreme Court's action by noting that the Kentucky court "did not specify either the precise infirmity in (its Rule) . . . or how Rule 7.3 cured it." 108 S. Ct. at 1920. It should be noted that Indiana's Rule 7.3(d) of the Rules of Professional Conduct also bans targeted, direct-mail solicitation although the language in the prohibition is more similar to the Kentucky rule replaced by Rule 7.3 than ABA Model Rule 7.

The Supreme Court, in reliance upon the rationale set forth in the line of lawyer advertising cases beginning with *Bates*, but primarily upon *Zauderer v. Office of Disciplinary Counsel*,<sup>12</sup> held that targeted, direct-mail solicitation, absent a showing that the mailing is false or misleading, is constitutionally protected commercial speech under the First and Fourteenth Amendments.<sup>13</sup> While the Court was careful to emphasize that states do have the right to prohibit false and misleading lawyer advertisements, they may not ban targeted, direct-mailing merely because of the potential for abuse in such practices.<sup>14</sup> In distinguishing between face-to-face solicitation, which states may categorically ban, and targeted direct-mailing, the Court noted "the mode of communication makes all the difference."<sup>15</sup>

According to the Court, a letter is like any other form of printed advertisement and "can be readily put in a drawer to be considered later, ignored or discarded."<sup>16</sup> The Court observed that personalized letters to potential clients with particular legal problems may indeed provide the unscrupulous lawyer with an opportunity to exaggerate the lawyer's familiarity with the case or imply that the legal problem is more serious than it actually is. However, this does not justify a blanket prohibition on this mode of commercial speech. The Court further suggests specific measures the states could take to ferret out solicitation letters which are false, misleading, or intimidating.<sup>17</sup> These measures will be discussed further in the next section of this Article.

There was a rather long and vigorous dissenting opinion in *Shapero* authored by Justice O'Connor.<sup>18</sup> For essentially the same reasons as set forth in the dissenting opinion in *Bates* and *Zauderer*, Justice O'Connor urged the majority to re-examine its entire rationale in the lawyer advertising cases.<sup>19</sup>

According to the dissent, states have a substantial and legitimate interest in banning any advertisement that undermines "the high ethical standards that are necessary in the legal profession."<sup>20</sup> In addition to

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12. 471 U.S. 626 (1985).

13. *Shapero v. Kentucky Bar Ass'n*, 108 S. Ct. 1916 (1988).

14. *Id.* at 1923.

15. *Id.* at 1922.

16. *Id.* at 1923.

17. *Id.*

18. *Id.* at 1925 (O'Connor, J., dissenting).

19. *Id.* In *Bates*, there were three dissenting opinions, one authored by Chief Justice Burger, who concurred in part and dissented in part; one by Justice Powell, who also concurred in part and dissented in part; and one by Justice Rehnquist, who dissented in part. Justice O'Connor wrote an eight-page dissent in *Zauderer* joined by Chief Justice Burger and Justice Rehnquist.

20. *Id.* at 1928.



the potential for misleading potential clients, targeted, direct-mail solicitation "has a tendency to corrupt the solicitor's professional judgment"<sup>21</sup> and furthermore tends to denigrate the profession as a whole.<sup>22</sup>

Justice O'Connor argues quite spiritedly that the legal profession has unique power in our political system and, therefore, special ethical standards may appropriately be applied to restrain attorneys. Justice O'Connor is skeptical that the marketplace alone can provide sufficient protection for consumers of legal services who often lack the ability to evaluate a legal advocate. Allowing the states to restrict and even impose blanket prohibitions upon advertising and solicitation practices which have a great potential for abuse serves several goals. First, such restrictions would protect potential clients from lawyers who make exaggerated or misleading claims regarding their experience or ability. Second, state imposed restrictions would also serve as a "concrete, day-to-day reminder to the practicing attorney of why it is improper for any member of this profession to regard it as a trade or occupation like any other."<sup>23</sup>

In short, the dissent bemoans the fact that the majority has allowed the spirit of consumerism to rule the day regarding the regulation of lawyer advertising. The dissent believes that leaving the important role of the regulation of lawyer advertising primarily to market forces will result in a further decline in the spirit of professionalism among attorneys, much to the detriment of the legal profession and the nation.<sup>24</sup>

*B. Shapero's Effect Upon Indiana's Regulation of Targeted, Direct-Mail Lawyer Advertising*

Rule 7.3(d)(1) of the Indiana Rules of Professional Conduct prohibits a lawyer from contacting or sending "a written communication to, a prospective client for the purpose of obtaining professional employment if (1) the contact or written communication is based upon the happening of a specific event . . . ."<sup>25</sup> Clearly, *Shapero* suggests this provision has little or no continued vitality as it relates to written communications targeted to specific clients. After *Shapero*, it seems highly unlikely that an Indiana lawyer could be disciplined for sending a targeted, direct-mail advertisement to those known to have a particularized need for legal services unless the letter contains false or misleading information.<sup>26</sup> However, it must be noted that Rule 7.3(d)(1) of Indiana's Rules of

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21. *Id.*

22. *Id.*

23. *Id.* at 1930.

24. *Id.* at 1931.

25. INDIANA RULES OF PROFESSIONAL CONDUCT Rule 7.3(d)(1) (1987).

26. *Shapero*, 108 S. Ct. at 1925.

Professional Conduct was not at issue in *Shapero* and remains a part of the rules until excluded by an amendment of the rules by the Indiana Supreme Court or expressly overruled by a court of competent jurisdiction.

However, it also seems certain that *Shapero* does not affect Indiana's prohibition against in-person solicitation. *Shapero* contains clear language indicating that the potential for abuse of attorney in-person solicitation was such that states could constitutionally categorically ban such a practice. There is also language in *Shapero* suggesting that Indiana and the other states may in fact continue to exercise considerable latitude in the regulation of even targeted, direct-mail advertisements if the focus of that regulation is restricted to an evaluation of each individual letter for false and misleading statements.<sup>27</sup>

While the majority in *Shapero* invalidated categorical bans of targeted, direct-mail lawyer advertisements by the states, the majority was careful to specify areas in which state regulation could continue to play an important role. According to Justice Brennan's opinion, the states could require lawyers to seek approval from a state agency for any solicitation letter or advertisement.<sup>28</sup>

The Court further suggests that this state regulatory agency could require lawyers who state specific facts in a solicitation letter to prove those facts by attaching court documents or materials which support the truth of the facts alleged. Agencies could further require lawyers to explain how these facts were discovered and what measures the lawyer took to verify the accuracy of the facts. The Court also noted that states could require that the letter contain "a label identifying it as an advertisement . . . or directing the recipient how to report inaccurate or misleading letters."<sup>29</sup> Thus, while the Supreme Court in *Shapero* has significantly expanded the ability of lawyers to market themselves, it suggests that Indiana and the other states retain the power to curb the more obvious excesses of targeted, direct-mail lawyer advertising. In fact, it is arguable that Indiana could, consistent with *Shapero*, enact measures

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27. *Id.* at 1925, 1928.

28. *Id.* at 1923. Whether a state could require prior approval for such letters appears to be an open question. The Court speaks of requiring lawyers to file prospective solicitation letters in order to give the states "ample opportunity to supervise mailings and penalize actual abuses." 108 S. Ct. at 1923. While this suggests states could require prior approval for solicitation letters, it does not specifically say so, even though the letter at issue in *Shapero* was presented to the Kentucky Bar Association prior to its being sent to anyone. It might well be argued that requiring the prior approval of solicitation letters constitutes a prior restraint upon free speech in violation of the First and Fourteenth Amendments. This issue seems likely to emerge in the event a state does impose a prior approval requirement for solicitation letters.

29. *Id.* at 1924.



which significantly restrict targeted, direct-mail lawyer solicitation.

For instance, if Indiana required lawyers to submit solicitation letters to an agency for approval, that act alone would likely discourage many lawyers from exerting the effort required to obtain the necessary approval. Furthermore, if the approval agency established the various requirements for approval of such letters as outlined in *Shapero*, it would seem that few lawyers would want to apply. For instance, if a lawyer was required to demonstrate the accuracy of all facts asserted, show how these facts were discovered, label the letter as an advertisement, and include information, presumably in a conspicuous place, as to the procedures for reporting inaccurate or misleading letters, the agency would likely not be overburdened with work. Given the well-established maxim that state agencies are not known for the speed with which they act, by the time *Shapero* would have had his letter approved from the hypothetical agency just described, the prospective client's house may have changed hands several times! In short, *Shapero* suggests that states can still erect substantial barriers for lawyers seeking to employ this method of marketing. Whether or not states will expend the energy and go to the expense of establishing another level of bureaucracy to deal with lawyer solicitation letters remains to be seen.

### C. *Shapero's Effect Upon Other Indiana Rules Regulating Lawyer Publicity and Advertising*

There are at least two other areas of regulated lawyer advertising practices which conceivably will be affected by the Supreme Court's ruling in *Shapero v. Kentucky Bar Association*.<sup>30</sup> The prohibition against commercial lawyer referral services<sup>31</sup> as well as the categorical bans upon certain types of information and data contained in lawyer advertisements are two such areas. The rationale set forth in Justice Brennan's opinion in *Shapero* suggests that the continuing validity of this categorical ban of commercial referral services may be suspect.

The minority opinion in *Shapero* disapproved of blanket prohibitions by states upon certain forms of lawyer advertising practices without a showing that the particular advertising practice in issue was false or misleading. The Court took pains to remind the states that lawyer advertising, like other forms of constitutionally protected commercial speech, may not be restricted except by means which are "no broader than reasonably necessary to prevent the' perceived evil."<sup>32</sup> The majority

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30. 108 S. Ct. 1916 (1988).

31. INDIANA RULES OF PROFESSIONAL CONDUCT Rule 7.3 (1987).

32. *Shapero v. Kentucky Bar Ass'n*, 108 S. Ct. 1916, 1921 (1988) (quoting *In re R.M.J.*, 455 U.S. 191, 203 (1982)).

in *Shapero* emphasized that the focus of inquiry in evaluating any particular mode of communication is upon two factors. First, it is necessary to inquire whether the practice involved is "rife with possibilities for overreaching, invasion of privacy, the exercise of undue influence and outright fraud."<sup>33</sup> The second factor is whether the practice is sufficiently visible to provide opportunities for effective regulation.<sup>34</sup> In applying that focus upon in-person solicitation, the Court ruled that a blanket prohibition was permissible.<sup>35</sup> As for targeted, direct-mail solicitations, the Court suggested other methods of regulation which were less restrictive than the invalidated categorical ban.<sup>36</sup> In applying the *Shapero* rationale to Indiana's blanket prohibition of commercial referral agencies by lawyers, it could be effectively argued that certain types of commercial referral agencies have less potential for abuse than does targeted, direct-mail solicitation.

For instance, if the referral agency restricts its advertising practices to the use of written newspaper advertisements and those on radio, or television, these forms of marketing would be available for scrutiny just as any other newspaper, radio or television lawyer advertisement. There would also appear to be less potential for fraud, undue influence, and overreaching through the use of a commercial referral agency as compared to targeted, direct-mailings.

Of course, if an advertisement encouraged the consumer to call a telephone number where a salesperson working on a commission basis pressures the caller to enlist a particular lawyer's services, such a practice is virtually analogous to the type of in-person solicitation which the Court and states may properly prohibit.<sup>37</sup> A categorical ban on the use of commercial referral agencies may not pass constitutional muster since a state could employ less restrictive means to regulate abuses, such as requiring approval of the particular advertising practices involved, a measure *Shapero* suggests is constitutionally permissible. With the growing popularity of television advertisements by commercial lawyer referral companies, it seems likely that a challenge to blanket prohibitions of commercial lawyer referral agencies may soon ensue.

Indiana rules which impose blanket prohibitions on specific types of information and data contained in advertisements by lawyers may also lack continued viability under *Shapero*. Rule 7.1(d) of the Indiana

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33. 108 S. Ct. at 1922 (1988) (quoting *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626, 641 (1985)).

34. 108 S. Ct. at 1922.

35. *Id.*

36. *Id.* at 1923.

37. See Moss, *The Ethics of Law Practice Marketing*, 61 NOTRE DAME L. REV. 601 (1986) (the author lists other policy considerations for this rule).



Rules of Professional Conduct prohibits, *inter alia*, lawyer advertising which "(2) contains statistical data or other information based on past performance or prediction of future success; (3) contains a testimonial about or endorsement of a lawyer; [or] (4) contains a statement of opinion as to the quality of the services. . . ." <sup>38</sup> The rationale for these prohibitions is that testimonials and endorsements normally contain references to the quality of the endorsed lawyer's services. Statements concerning the quality of legal services are banned generally for the reason that such claims are not subject to factual verification. <sup>39</sup>

However, it has been common practice for many years for lawyer information services such as Martindale-Hubbell and the Indiana Legal Directory to list regularly represented clients as part of the biographical sketch. Although Indiana has not adopted ABA Model Rule 7.2 *in toto*, this provision allows lawyers to list regularly represented clients in lawyer advertisements. <sup>40</sup> It is difficult to justify the distinction between permitting a lawyer to list regularly represented clients and prohibiting the use of endorsements and testimonials. Listing regularly represented clients is surely an implied endorsement if not a testimonial. <sup>41</sup>

Furthermore, a categorical ban on testimonials and endorsements may be difficult to sustain under *Shapero*. Given the Court's concern in protecting "the free flow of commercial information," <sup>42</sup> demonstrating the necessity of a blanket prohibition of certain types of information in lawyer advertisements might prove to be a formidable task unless the regulatory body is able to prove that testimonials and endorsements are inherently deceptive. <sup>43</sup> It could be, as Justice O'Connor argues in the

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38. INDIANA RULES OF PROFESSIONAL CONDUCT Rule 7.1(d) (1987).

39. Rule 7.1(d)(4) bans public communications by a lawyer which "contains a statement or opinion as to the quality of the services or contains a representation or implication regarding the quality of legal services." *Id.*

40. MODEL RULES OF PROFESSIONAL CONDUCT Rule 7.2 (1978).

41. Moss, *supra* note 37. This Article suggests the Model Rules on advertising are "biased" in favor of firms with a business and commercial practice and against personal injury and criminal defense lawyers. Commercial practice firms generally have "regularly represented clients" while criminal defense and personal injury firms do not. *Id.*

42. *Shapero v. Kentucky Bar Ass'n*, 108 S. Ct. 1916, 1924 (1988).

43. Apparently, the United States Supreme Court will soon be ruling on the issue of client testimonials in lawyer advertising. On June 30, 1988, the Supreme Court noted probable jurisdiction in *Oring v. State Bar of Cal.*, 108 S. Ct. 2895 (1988). Oring is a California lawyer and a member of the law firm of Grey and Oring. Grey had previously received a public reprimand for a radio advertisement which contained a client testimonial praising the firm for obtaining a large insurance settlement but failed to state that a major portion of the settlement related to a bad faith claim. Grey sought certiorari from the United States Supreme Court to review the discipline imposed upon him. Certiorari was denied in Grey's case in January 1987. *Grey v. State Bar of Cal.*, 479 U.S. 1034 (1987). It was agreed in Oring's case that Oring would receive the same discipline as Grey.

dissent to *Shapero*, that the ability of the states to regulate lawyer advertising in any meaningful way is greatly impaired by the majority's reliance upon the notion that the marketplace can appropriately determine lawyer selection. The majority's unwarranted faith in the spirit of consumerism to control the advertising methods of lawyers may well lead to a significantly diminished sense of professionalism among the Bar as Justice O'Connor so forcefully points out. Whether the Court further extends the limits of permissible lawyer marketing is unquestionably of great significance not only to those attorneys anxious to use all forms of advertising methods available to increase their practices but also to members of the profession concerned about the overall effect of such a development. Given the obvious willingness of lawyers to test limits, it seems certain that the profession will ultimately, if not soon, learn the boundaries of *Shapero*.

### III. PROFESSIONAL LIABILITY: THE DECISION TO SETTLE OR PROCEED TO TRIAL IN PERSONAL INJURY CASES

Attorneys' malpractice related to the settlement of personal injury cases is a troublesome issue for practitioners. In *Sanders v. Townsend*,<sup>44</sup> the Indiana Court of Appeals considered this issue in a case where a client claimed her attorney coerced her to accept an inadequate and unfair settlement. *Sanders* addressed several matters of first impression in Indiana.

In *Sanders*, the appellant was injured in an automobile accident with a third party. Following the accident, Mrs. Sanders and her husband retained the appellee, Townsend, to represent her in a claim for damages and her husband for loss of consortium. After the suit was filed, Townsend negotiated a \$3,000 settlement which the Sanders accepted.

The Sanders subsequently filed a malpractice action against Townsend claiming they were coerced into an unfair and inadequate settlement. The trial court granted a motion for summary judgment in favor of Townsend which the Sanders appealed.

The Indiana Court of Appeals separated the case into two issues, attorney negligence/malpractice, and constructive fraud, which it discussed separately. Each of the two issues raised a matter of first impression in Indiana. The court discussed the issue of the negligence claim first. The court of appeals held that the evidence submitted by the parties

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after the *Grey* decision was final. At issue is the validity of California's rules prohibiting deceptive or misleading advertisements and client testimonials. Rule 7.1(d)(3) of Indiana's Rules of Professional Conduct prohibits lawyer advertising containing client testimonials and will certainly be affected by the Court's decision in *Oring*.

44. 509 N.E.2d 860 (Ind. Ct. App. 1987).



did raise a material issue as to whether Townsend breached the duty he owed to his clients. The court next considered the level of proof required by each party on the issue of damages.

The court noted that the burden of proof necessary to defeat a defendant's motion for summary judgment in the context of an alleged inadequate settlement or jury award is an issue which had not been previously addressed in Indiana. However, the court followed other recent decisions on this issue in finding that "a plaintiff, in proving attorney negligence in the context of challenging a settlement or jury award as inadequate, must show, had the attorney not been negligent, the settlement or verdict award would have been greater."<sup>45</sup> In applying this standard to the case before them, the court held that Sanders had failed to present facts admissible in evidence to raise a material issue as to the adequacy of the settlement issue.

In opposition to Townsend's summary judgment motion, Mr. and Mrs. Sanders each submitted affidavits expressing their view that a scar on Sanders' forehead was worth more than \$3,000. In evaluating this evidence, the court stated that "[a] litigant's personal opinion of a scar's value to the litigant, standing alone, is irrelevant to the issue of the settlement value of the scar."<sup>46</sup>

The court of appeals also held as inadmissible two other documents submitted by Sanders on the issue of damages. One document was an evaluation of the Sanders' claim prepared by Jury Verdict Research, Inc., with an attached affidavit by counsel for Sanders setting forth the information supplied to the company. However, since the author of the evaluation report did not submit an affidavit in compliance with Trial Rule 56,<sup>47</sup> the court of appeals ruled the report valuing the Sanders' claim at \$17,500 to be inadmissible hearsay. Correspondingly, the court also ruled excerpts from Verdict Magazine as hearsay. The trial court did not consider either document in its ruling on defendant's motion for summary judgment, and the court of appeals affirmed the trial court's decision in granting summary judgment in favor of Townsend.<sup>48</sup>

The court of appeals, however, reversed the trial court's granting of summary judgment on the issue of Townsend's alleged constructive fraud. The court noted that an allegation of constructive fraud raises different issues than a claim of attorney negligence.

In a case involving an attorney negligence claim, "the injury is the loss of the worth of the underlying claim; but, with respect to constructive

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45. *Id.* at 863.

46. *Id.* at 864.

47. IND. R. TR. P. 56.

48. 509 N.E.2d at 864-65.

fraud where fiduciary duties are breached, the primary injury is the loss of rights belonging to the weaker party.”<sup>49</sup> In applying this distinction to the facts of the case, the court of appeals noted that the injury under the constructive fraud claim “is the deprivation of the right to choose between trial or settlement, or rejection of one settlement offer in the hopes of a better offer.”<sup>50</sup> Thus, the value of the underlying claim is not the full measure of recoverable damages on the issue of constructive fraud.

In attempting to show a deprivation of her rights, Mrs. Sanders submitted a deposition which contained, *inter alia*, an allegation that Townsend threatened to lose her file if she did not settle the case for \$3,000. The Indiana Court of Appeals ruled that, unlike the first case involving attorney negligence, the facts asserted in the deposition raise a material issue of fact regarding the claim of constructive fraud. The fact that Sanders failed to submit competent evidence on the issue of the adequacy of the settlement award is not dispositive of the constructive fraud claim because the measure of damages in each cause of action differs.

The court went on to point out that while nominal damages may be awarded in cases where a party has proved an injury as a result of a fraud, forfeiture of the attorney’s fees may also be appropriate.<sup>51</sup> In making the suggestion that the forfeiture of attorney fees is a proper element of damages, the court of appeals cited a Minnesota case in which the lawyer representing one client in the settlement of a personal injury case simultaneously represented the insurance adjuster on other matters.<sup>52</sup> After finding that the lawyer’s conflict of interest constituted an act of fraud, the Minnesota court held that forfeiture of the attorney’s fees was an appropriate remedy.

The court’s ruling in *Sanders* raises a number of interesting issues. The first issue is the level of proof required for a plaintiff to defeat a Trial Rule 56 motion in an attorney malpractice action based upon an allegation of a coerced settlement. *Sanders* suggests that a plaintiff will be foreclosed from proceeding on a negligence claim without presenting probative and admissible evidence as to value of the underlying claim in addition to evidence tending to show acts of coercion.<sup>53</sup>

However, establishing the value of a personal injury claim is frequently a difficult matter. Unlike tangible commercial items, there is no

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49. *Id.* at 866.

50. *Id.* at 867.

51. *Id.*

52. *Rice v. Perl*, 320 N.W.2d 407 (Minn. 1982). The possible significance of this case is discussed later in this section. See *infra* notes 60-61 and accompanying text.

53. *Sanders*, 509 N.E.2d at 864.



market to provide an objective value for personal injury claims. Even though comparing jury verdicts in cases involving similar factual situations may be helpful in fixing the approximate value of a particular case, personal injury lawsuits are frequently known for the unique characteristics of the variable factors of the cases. In fact, trial lawyers might want to argue that an important, if not the most important, factor in the ultimate outcome of the case is the relative skill of the litigators involved. Certainly, the value of the personal injury claim is in many respects a matter of opinion.

It is interesting to note that the court in *Sanders* held that the opinion of the victims as to the value of the injuries suffered by them lacks sufficiency to raise a matter of factual dispute within the meaning of Trial Rule 56. The probative value of this type of evidence relative to a Trial Rule 56 motion is a matter of conjecture because the court held verdict comparisons inadmissible due to the form in which the evidence was offered. Certainly *Sanders* suggests that future plaintiffs must take special care in submitting proper proof as to the value of the underlying personal injury claim when defending a summary judgment motion in a case of an alleged coerced settlement.

However, the court of appeals decision in *Sanders* suggests several reasons why a claim of constructive fraud against an attorney is more likely to survive a motion for summary judgment than a claim based upon a negligence theory. First of all, the court noted that no intent is required in a case of constructive fraud.<sup>54</sup> Furthermore, duty is firmly established as a result of the attorney-client relationship. Also, a client will usually be able to easily establish that he or she relied on the attorney's statements, or silence, in view of the attorney's superior knowledge and training. Of course, evidence as to what the attorney did or did not advise will often be in dispute.

Even more importantly, the issue of damages poses a significantly lower barrier to recovery in a constructive fraud case than in the case of attorney malpractice grounded solely upon negligence. Damages in a constructive fraud case are not limited by the value of the underlying claim as is a claim based upon a negligence theory. The primary injury resulting from an act of constructive fraud is not the value of the claim, but the deprivation of the client's right to make a choice between settling on the terms of an offer or proceeding to trial. Damages which flow from the attorney's depriving his client of an informed choice may be nominal, or, as the court of appeals suggested in *Sanders*, may include the forfeiture of the attorney's fees collected in the settlements.<sup>55</sup>

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54. *Id.* at 866.

55. *Id.* at 867.

It is, however, an open question as to whether a client who proves the elements of constructive fraud can also recover the value of the underlying claim less the amount of settlement in addition to the forfeiture of attorney's fees. It is, of course, well established that rescission and restitution are the remedies for fraud and constructive fraud actions, a fact specifically noted by the court of appeals in *Sanders*.<sup>56</sup> However, a skillful trial lawyer might well offer an argument that rescission and restitution in a case of a coerced settlement require placing the client in the position he or she held prior to the fraudulent act. Restoring the status quo in a case of constructive fraud means putting the client in a position he or she held prior to acts of fraud.

If this argument is accepted, the client has the opportunity of seeking full value of his or her underlying claim. However, establishing that claim may prove difficult as previously discussed. In an especially aggravated case, an aggrieved client could conceivably recover punitive damages.<sup>57</sup>

It is also important to note that under the recently adopted Rules of Professional Conduct, specific language requires the lawyer to "abide by a client's decision whether to accept an offer of settlement."<sup>58</sup> The rules also now require contingent fee agreements to be in writing.<sup>59</sup> It would, therefore, seem prudent for the practitioner to set forth in the fee agreement the process by which settlement offers shall be presented to the client and the method by which the client shall reach the decision.

Lawyers may find it to their advantage to include language in all written fee agreements that all offers of settlement will be communicated to the client, possibly in writing, and that the client will be responsible for making a final determination regarding the settlement offer. An attorney may set out how he or she will advise the client, what relevant considerations exist, and all other necessary information so that the client may make an informed decision in regard to the settlement offer. By properly documenting the manner by which settlement offers are communicated and the process by which the client reaches the decision regarding the offer, the attorney can possibly avoid a future malpractice claim alleging coerced settlement.

*Sanders* also causes one to wonder about the extent to which the rationale will be applied to other instances of alleged attorney misconduct. The court relied upon a Minnesota Supreme Court case for the proposition that a client may recover as damages the attorney fees in cases

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56. *Id.*

57. See e.g., *Bud Wolf Chevrolet, Inc. v. Robertson*, 519 N.E.2d 135 (Ind. 1988); *Millison v. Hoch*, 17 Ind. 227 (1861).

58. INDIANA RULES OF PROFESSIONAL CONDUCT Rule 1.2(a) (1987).

59. *Id.* Rule 1.5(c).



where constructive fraud is proven.<sup>60</sup> The Minnesota case concerned a conflict of interest by the attorney in the communication of a settlement offer rather than any overt conduct indicating coercion. In the Minnesota case the attorney was representing a personal injury client while his firm simultaneously represented the insurance adjuster on other matters.<sup>61</sup>

If an action for constructive fraud can be brought against an attorney who violates a conflict of interest provision, a major new area of attorney malpractice may be opened. Law firms and attorneys providing a broad range of legal services frequently find themselves simultaneously representing clients adverse to former or even present clients. *Sanders* may be a warning for attorneys to give even more attention to this troublesome matter.

#### IV. INDIANA DISCIPLINARY CASES

##### *A. Conflict of Interest and Improper Use of Client Confidences*

In *In re Orbison*,<sup>62</sup> the Indiana Supreme Court found that an attorney had violated the conflict of interest rules<sup>63</sup> by his firm having prepared a will in which the lawyer and other members of his family received substantial bequests without having advised the client of the potential conflict in such bequests nor advising the client to consult with independent counsel. The court also found that the Respondent, as Executor, violated the Indiana Code of Professional Responsibility<sup>64</sup> by making partial distributions of the client's estate to himself and other members of his family, several months prior to making distributions to other legatees, and paying executor fees to himself and attorneys fees to another member of his firm without prior court approval.

In approving the Conditional Agreement which called for a public reprimand, the court cited several mitigating circumstances. Respondent's prior unblemished record and his long service to the practicing bar were two mitigating factors. Another consideration was the fact that the Respondent himself did not actually prepare the will and he was unaware of its terms until it was probated. Finally, the decedent was a close family friend of Respondent for over thirty years.

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60. *Rice v. Perl*, 320 N.W.2d 407 (Minn. 1982).

61. *Id.* at 410-11.

62. 524 N.E.2d 792 (Ind. 1988).

63. IND. CODE OF PROFESSIONAL RESPONSIBILITY DR 5-101(A) and DR 5-105(D) (1986) (the two conflict of interest rules cited by the court).

64. The court ruled that Respondent's actions also violated the CODE OF PROFESSIONAL RESPONSIBILITY DR 1-102(A)(5), (6); DR 2-105(A); DR 7-101(A)(1), (3); DR 7-103(A)(2), (8), and DR 9-102(B)(1), (3), (4).

Under the recently adopted Rules of Professional Conduct,<sup>65</sup> the facts here establish a much stronger case for discipline than under the former Code of Professional Responsibility which was in effect when the conduct in issue occurred. Under the conflict of interest rules in the former Code, it has been widely held that testamentary bequests from a client to an unrelated lawyer were presumed to be the result of fraud or overreaching.<sup>66</sup> Although this presumption was considered rebuttable, a lawyer who was a beneficiary under a will he or she had written had a very difficult burden to prove that the decedent's bequest was the product of an informed choice made after full disclosure.

Under Rule 1.8(c) of the Rules of Professional Conduct, it is now a *per se* violation to "prepare an instrument giving the lawyer or a person related to the lawyer as parent, child, sibling or spouse any substantial gift from a client including a testamentary gift, except where the child is related to the donee."<sup>67</sup> It is no longer possible to avoid a disciplinary sanction by showing that the decedent's gift to an unrelated lawyer was a voluntary act performed after full disclosure. If the lawyer is not related to the donee and the gift is substantial, a lawyer may not prepare a will or any other instrument which makes the lawyer a beneficiary.

Of course the definition of "substantial gift" may prove fertile ground for future interpretation. The language providing an exception for lawyers related to the donee will likely result in judicial interpretations as to limits of this exception. It is not difficult to imagine that a lawyer who is distantly related by marriage to an elderly, wealthy client may have trouble relying exclusively upon this exception if the lawyer receives a substantial bequest when there are other closely related, or prospective, heirs.<sup>68</sup>

A loan from a client to a lawyer which was the product of a written instrument prepared by the lawyer's law partner was ruled a violation of the Code of Professional Responsibility in *In re Briggs*.<sup>69</sup> In accepting

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65. INDIANA RULES OF PROFESSIONAL CONDUCT Rule 1.8(c) (1987).

66. *In re Anderson*, 52 Ill. 2d 202, 287 N.E.2d 682 (1972); Committee on Professional Ethics & Conduct v. Behnke, 276 N.W.2d 838 (Iowa 1979); Marron v. Bowen, 235 Iowa 108, 16 N.W.2d 14 (1944); Cline v. Larson, 234 Or. 384, 383 P.2d 74 (1963); Estate of Younger, 314 Pa. Super. 480, 461 A.2d 259 (Pa. Super. 1983); *In re Theodosen*, 303 N.W.2d 104 (S.D. 1981); *In re Swan's Estate*, 4 Utah 2d 277, 293 P.2d 682 (1956); *In re Spenner's Estate*, 17 Wis. 2d 645, 117 N.W.2d 641 (1962). *Contra* State v. Horan, 21 Wis. 2d 66, 123 N.W.2d 488 (1963), cited in ABA, BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT, 51:601.

67. INDIANA RULES OF PROFESSIONAL CONDUCT Rule 1.8(c) (1987).

68. In Florida Bar v. Shapiro, 413 So. 2d 1184 (Fla. 1982), a lawyer was suspended for two years for accepting *inter vivos* and testamentary gifts from an older woman even though it was found that no attorney client relationship existed between the two.

69. 502 N.E.2d 879 (Ind. 1987).



the Conditional Agreement which called for a public reprimand, the Indiana Supreme Court chided Respondent for failing to apprise his client of the differing interests at stake in a relationship which is "always potentially and often inherently (adversarial) in nature."<sup>70</sup> The court also found a DR 6-102<sup>71</sup> violation in Respondent's attempt to exonerate himself from prospective liability through other language in the written agreement providing for the loan.

The circumstances under which a lawyer may enter into business transactions with a client or acquire an economic interest adverse to a client are now set forth in clear and concise language under the Code of Professional Conduct. According to Rule 1.8(a), the terms of the transaction must be fully disclosed and in writing, as must be the client's consent, only after "the client is given a reasonable opportunity to seek the advice of independent counsel."<sup>72</sup> It is a further requirement under Rule 1.8(a) that the terms be fair and reasonable to the client. Thus, Rule 1.8(a) provides definitive guidelines as to the acceptable behavior on the part of lawyers who seek to engage in business transactions with clients. It does not, however, appreciably change the standards as they were previously applied in cases decided under the former disciplinary rules, as the cases indicated, a lawyer has a very heavy burden of showing that gifts from a client were the product of a fully informed choice.

In a review of a hearing officer's findings in a contested disciplinary case, the Indiana Supreme Court found that the evidence supported a finding that a part-time prosecutor had violated the conflict of interest rules in three separate instances.<sup>73</sup> The court found a violation in Respondent's representing a client in a dissolution action while Respondent's deputy was simultaneously prosecuting the client in a URESA action.<sup>74</sup>

The court further held that it was a violation of DR 4-101(A)<sup>75</sup> for the prosecutor to have filed a bigamy charge against a woman who had sought Respondent's assistance in his private capacity to resolve her problem of being married to two men at the same time.<sup>76</sup> The final violation rested upon evidence showing that Respondent represented a client in a divorce contempt matter arising from an incident which resulted in the man's former spouse making a criminal charge against Respondent's client which Respondent refused to file.<sup>77</sup> The court found the

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70. *Id.* at 880.

71. INDIANA CODE OF PROFESSIONAL RESPONSIBILITY DR 6-102 (1986).

72. INDIANA RULES OF PROFESSIONAL CONDUCT Rule 1.8(a) (1987).

73. *In re Moerlein*, 520 N.E.2d 1275 (Ind. 1988).

74. *Id.* at 1277-78.

75. INDIANA CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101(A) (1986).

76. *Moerlein*, 520 N.E.2d at 1278.

77. *Id.* at 1279.

evidence lacking on several other similar allegations, yet assessed a public reprimand.<sup>78</sup>

Conflict between the private and public functions of part-time prosecutors is an area of continuing concern.<sup>79</sup> In September 1987, the Indiana Supreme Court adopted Rule 1.8(k) of the Rules of Professional Conduct which, *inter alia*, allows part-time deputy prosecutors to represent clients in dissolution actions if there exists a prior written arrangement excluding that part-time deputy prosecutor from exercising prosecutorial authority in family law matters.<sup>80</sup> By creating a useful mechanism for part-time deputy prosecutors to engage in the representation of divorce clients, the court has made it possible for Indiana's part-time deputy prosecutors to maintain a civil dissolution practice while serving the criminal justice system. This situation is a matter of special concern to prosecutors in rural counties who are statutorily precluded from full-time prosecutor status and where opportunities for civil cases are somewhat more limited.

The only other case involving conflict of interest or client confidences issues decided during the survey period was *In re Swihart*.<sup>81</sup> In *Swihart*, a lawyer received a thirty-day suspension from the practice of law where the lawyer had become personally involved in an adoption matter adverse to his client.<sup>82</sup>

### B. Personal Misconduct

The improper use of alcohol and drugs resulted in three court imposed disciplinary sanctions during the survey period. In *In re Petit*<sup>83</sup> and *In re Musser*,<sup>84</sup> both Respondents were deputy prosecutors convicted of

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78. *Id.*

79. See Jackson, *Developments in Professional Responsibility*, 21 IND. L. REV. 291, 304-06 (1988).

80. INDIANA RULES OF PROFESSIONAL CONDUCT Rule 1.8(k) (1987) provides: A part-time prosecutor or deputy prosecutor authorized by statute to otherwise engage in the practice of law shall refrain from representing a private client in any matter wherein exists an issue upon which said prosecutor has statutory prosecutorial authority or responsibilities. This restriction is not intended to prohibit representation in tort cases in which investigation and any prosecution of infractions has terminated, nor to prohibit representation in family law matters involving no issue subject to prosecutorial authority or responsibilities. Upon a prior, express written limitation of responsibility to exclude prosecutorial authority in matters related to family law, a part-time deputy prosecutor may fully represent private clients in cases involving family law.

81. 517 N.E.2d 792 (Ind. 1988).

82. *Id.* at 794.

83. 517 N.E.2d 396 (Ind. 1988).

84. 517 N.E.2d 395 (Ind. 1988).



driving while intoxicated arising from traffic accidents. In both cases, the court approved a conditional agreement imposing a public reprimand. The Indiana Supreme Court also ruled that the conduct in question in both cases violated DR 1-102(A)(5) as conduct prejudicial to the administration of justice. However, the court refused to find a violation of DR 1-102(A)(3) in *Musser* or a DR 1-102(A)(6) violation in *Petit*.

In *In re Jones*,<sup>85</sup> the Indiana Supreme Court imposed a public reprimand in approving a conditional agreement where an attorney was convicted of possession of marijuana. In holding that Respondent's behavior reflected adversely on Respondent's fitness to practice law but was not an act of moral turpitude, the court explained its view as to the relative seriousness of possession of marijuana as compared with driving while intoxicated.<sup>86</sup>

The court evaluated the facts in *Jones* in light of the standards set forth in *In re Oliver*.<sup>87</sup> The court stated that the use of alcohol is legal for adults, and even intoxication is not a crime unless in public or it involves drunk driving. The court concluded that the misuse of alcohol in itself does not necessarily affect the fitness of a lawyer to practice law.<sup>88</sup>

However, the use and possession of marijuana, according to the court, is a different situation. The act of possession of marijuana requires inevitable contact with the trafficking of illegal drugs. The court further stated that the public views such acts as inconsistent with the lawyer's role as an officer of the court. The court concluded that the act of possession of marijuana by Respondent in itself reflects adversely on his fitness to practice law. The court proceeded to conclude that the facts presented in *Jones* were insufficient to support a finding that Respondent had committed an act of "moral turpitude."<sup>89</sup>

The court's comparison of drunk driving and marijuana possession is interesting. The court reasons that the public's perception of a lawyer who possesses marijuana is so severely negative that it adversely affects the lawyer's fitness to be an officer of the court. However, the court apparently believes the public does not view the offense of drunk driving in the same light because drunk driving involves the misuse of a legal drug, alcohol, rather than an illegal one, marijuana. Presumably, the

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85. 515 N.E.2d 855 (Ind. 1987).

86. *Id.*

87. In *In re Oliver*, 493 N.E.2d 1237, 1242-43 (Ind. 1986), the Indiana Supreme Court ruled that a lawyer's private misconduct which affect the lawyer's trustworthiness also affects the lawyer's fitness to practice law. The court also held that it would analyze the particular conduct *in toto* to determine whether the behavior involves moral turpitude. *Id.* at 1241.

88. *Id.*

89. *Jones*, 515 N.E.2d at 856.

fact that marijuana possession puts the lawyer in contact with drug trafficking is a more serious consideration for the public in evaluating the character of this conduct, than evaluating the relative dangerousness of drunk driving.

The treatment of acts involving private misconduct by lawyers under the recently adopted Rules of Professional Conduct raises some interesting questions. Rule 8.4 of the newly adopted Rules of Professional Conduct avoids the use of the phrase "illegal conduct involving moral turpitude" as formerly contained in DR 1-102(A)(3) of the Code of Professional Responsibility.<sup>90</sup> The comments to Rule 8.4 indicate that the authors specifically excluded such language to limit lawyer disciplinary cases to instances of personal morality which are specifically connected to the fitness for the practice of law.<sup>91</sup>

Conduct which directly affects the administration of justice or a lawyer's honesty is given special attention under Rule 8.4. Much of the language used to define misconduct under Rule 8.4 is virtually identical to the prohibitions formerly contained in DR 1-102(A).

The *Petit* and *Musser* cases suggest that lawyers who are public officials or prosecutors will violate Rule 8.4(d) of the Rules of Professional Conduct by engaging in drunk driving. *Jones* suggests lawyers who are in possession of marijuana will violate Rule 8.4(b) of the Rules of Professional Conduct as adversely affecting a lawyer's fitness.

Because Rule 8.4 contains no reference to moral turpitude, acts of drunk driving by attorneys who are not public officials or prosecutors will likely be evaluated with reference to the issue of the lawyer's fitness under Rule 8.4(b). However, this probably will not change the outcome of such cases.

In *Jones* the court considered the public's perception of the character of a lawyer's act of private misbehavior (marijuana possession) as an important factor in evaluating a lawyer's fitness.<sup>92</sup> The "judgment of

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90. INDIANA RULES OF PROFESSIONAL CONDUCT Rule 8.4 (1987) provides:

It is professional misconduct for a lawyer to:

- (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;
- (b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;
- (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;
- (d) engage in conduct that is prejudicial to the administration of justice;
- (e) state or imply an ability to influence improperly a government agency or official; or
- (f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law.

91. INDIANA RULES OF PROFESSIONAL CONDUCT Rule 8.4 comment (1987).

92. 515 N.E.2d at 856.



the community" and "the state of the public morals" are likewise considerations in the definition of moral turpitude according to the court in *In re Oliver*.<sup>93</sup> Thus, if the public's perception of an attorney's private act of misconduct is a meaningful consideration in evaluating a lawyer's fitness, behavior formerly considered an act of moral turpitude will continue to be violations of the Rules of Professional Conduct under Rule 8.4(b). Because the acts of marijuana possession and repeated acts of drunk driving have been held to adversely affect the lawyer's fitness under certain circumstances, these behaviors may be prohibited under Rule 8.4(b).

Whether the court will apply the same analysis to other behavior formerly considered to be acts of "moral turpitude," such as sexual misconduct, is an open question. Presumably, if the misconduct is illegal and adversely reflects in any manner on the lawyer's honesty, trustworthiness, or the lawyer's fitness, the act will violate Rule 8.4(b). If the act is not illegal, the act may violate Rule 8.4(d) as "conduct prejudicial to the administration of justice" if the conduct in question carries a stigma of significant public disapproval. If the court considers the conduct in question as carrying a significant negative stigma by the public, the conduct may then be characterized as adversely affecting "the public's perception of (the attorney's) fitness to be an officer of the court,"<sup>94</sup> thereby violating Rule 8.4(d).

### C. Other Indiana Cases

During the survey period, there were several other disciplinary cases decided by the Indiana Supreme Court which will be given brief comment. In a recently reported case, the court imposed a one year suspension from the practice of law on a lawyer for twice submitting false documents to an administrative law judge at a social security hearing.<sup>95</sup> On both occasions, the lawyer filed a backdated Requested For Hearing form with the Social Security Administration which contained a forged signature of a social security employee. The court ruled that such behavior was an intentional misrepresentation of an adjudicatory body and deserved the serious sanction of a suspension.<sup>96</sup>

A one year suspension was also imposed in *In re Holloway*<sup>97</sup> where a lawyer wrote a bad check to pay medical bills on behalf of a client and failed to repay the amount owed for twenty-one months. The court

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93. 493 N.E.2d at 1241.

94. *In re Jones*, 515 N.E.2d at 856.

95. *In re Brown*, 524 N.E.2d 1291 (Ind. 1988).

96. *Id.* at 1293.

97. 514 N.E.2d 829 (Ind. 1987).

further found an act of misconduct in Respondent's failure to pay medical bills for two years for a second client from funds Respondent received for that purpose. The court ruled that Respondent's failure to repay a \$5,000 loan from another client was an additional act of misconduct supporting its imposition of the one-year suspension.<sup>98</sup>

In the five reported cases involving acts of serious neglect of clients by attorneys, the Indiana Supreme Court imposed suspensions from the practice of law ranging from thirty days to disbarment. The sanctions imposed in the cases reflected the degree of aggravated circumstances as tempered by the various facts of mitigation.<sup>99</sup>

In a case where an attorney had negotiated a contingency fee in a criminal case, the Indiana Supreme Court approved a conditional agreement imposing a public reprimand.<sup>100</sup> The court pointed out in its opinion that the fee arrangement was clearly a violation of DR 2-105(c) of the Code of Professional Responsibility at the time it was negotiated and would further be a violation of Rule 1.5(d)(2) of the newly adopted Rules of Professional Conduct.<sup>101</sup>

In the final case for comment in this Article, the Indiana Supreme Court imposed a public reprimand in approving a conditional agreement where an attorney had failed to return a client's file in a criminal post-conviction relief matter after having promised to do so and having collected a fee. The court noted several mitigating facts in agreeing to accept the conditional agreement.<sup>102</sup>

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98. *Id.* at 831.

99. See *In re Brown*, 519 N.E.2d 1216 (Ind. 1988); *In re Woods*, 516 N.E.2d 33 (Ind. 1987); *In re Geron*, 515 N.E.2d 853 (Ind. 1987); *In re Erbecker*, 513 N.E.2d 1214 (Ind. 1987); *In re Carmody*, 513 N.E.2d 649 (Ind. 1987).

100. *In re Stivers*, 516 N.E.2d 1066 (Ind. 1987).

101. *Id.*

102. *In re Taylor*, 525 N.E.2d 286 (Ind. 1988.)





# Indiana's New Guardianship Code: A New Emphasis on Alternative Forms of Protection

DAVID M. BERRY\*

## I. INTRODUCTION

One of the most significant considerations that precipitated the wholesale amendment of Indiana's guardianship statutes with the enactment of Indiana's New Guardianship Code (the "NGC")<sup>1</sup> was the concern of many groups, especially senior citizen groups, that it was too easy to place a person under the protection of a guardianship.<sup>2</sup> Yet, it was also recognized that, in many cases, even though a guardianship may have been too easily established, the protected person<sup>3</sup> was in need of some form of assistance.<sup>4</sup> To provide assistance to individuals in situations where a full guardianship proceeding is unnecessary, the NGC provides various alternative proceedings in lieu of a guardianship.<sup>5</sup> In addition, the NGC does not affect and still permits other traditional statutory alternatives to a guardianship.<sup>6</sup>

This Article first offers a discussion of some of the alternative proceedings and approaches to a guardianship and their potential application to individuals in need of a level of assistance somewhat less than a full guardianship. Then, some of the NGC's more significant provision concerning guardianships will be examined. This discussion will include: the creation of a guardianship by the appointment of a

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\* Associate, Lowe Gray Steele & Hoffman, Indianapolis. B.A., University of Denver, 1981; J.D., Indiana University School of Law—Indianapolis, 1988. [As this Article was going to print, certain amendments to the New Guardianship Code were being considered by the Indiana General Assembly. The reader should be aware of the fact that some of the code sections cited in this Article may have been amended by the Legislature.—Ed.]

1. IND. CODE §§ 29-3-1-1 to -13-3 (1988).

2. Gates, *Background: A History of the Development of House Bill 1113*, ICLEF GUARDIANSHIP SEMINAR I-2 (1988); Gordon, *Small Estates, Parental Powers and Temporary Guardians*, ICLEF GUARDIANSHIP SEMINAR III-1 (1988).

3. Under the NGC, the term "protected person" replaces the word "ward" under prior Indiana law. IND. CODE § 29-3-1-13 (1988) defines "protected person" as "an individual for whom a guardian has been appointed or with respect to whom a protective order has been issued."

4. Gordon, *supra* note 2, at III-1.

5. See IND. CODE § 29-3-3-1 to -5 (1988).

6. Emison, *Alternatives to Guardianship*, ICLEF GUARDIANSHIP SEMINAR X-8 (1988).



guardian; the powers and duties of a guardian; the removal of a guardian; the termination of a guardianship; and foreign guardianships. This Article will not attempt to analyze every important new provision of the NGC and, as such, the practitioner is well advised to review the new Act in its entirety to represent clients most effectively.

## II. ALTERNATIVES TO GUARDIANSHIPS

### A. Facility of Payment

1. *Minors*.—The NGC permits a person who is either indebted to a minor<sup>7</sup> or who possesses property belonging to a minor in an amount not exceeding \$3,500 to pay the debt or deliver the property to certain persons without the appointment of a fiduciary, the giving of a bond or court order.<sup>8</sup> These NGC facility of payment provisions recognize that, in many situations, a minor needs financial assistance<sup>9</sup> even though the dollar amount of the transaction might be small. These provisions are designed to eliminate the “expense and complexity” of guardianship proceedings,<sup>10</sup> as well as to provide “some sense of security for the transferor.”<sup>11</sup> In addition, safeguards concerning the use of the property for the benefit of the minor<sup>12</sup> exist under the NGC’s duties of care imposed upon the recipient.

The NGC provides that property with value not exceeding \$3,500 may be paid to certain individuals without the need for any protective proceedings.<sup>13</sup> The NGC differs from the Uniform Guardianship and Protective Proceedings Act<sup>14</sup> (the “Uniform Act”) because the Uniform Act provides a higher ceiling of \$5,000 per year<sup>15</sup> relating to these facility of payment provisions. The NGC seemingly retains the lower \$3,500 amount from prior Indiana law concerning the small estates of minors.<sup>16</sup> Yet, the NGC differs from prior Indiana law on this matter because the \$3,500 threshold in the prior law related to “the whole estate of a

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7. IND. CODE § 29-3-1-10 (1988) defines the term “minor” as “an individual who is less than eighteen (18) years of age.”

8. IND. CODE § 29-3-3-1 (1988).

9. Gordon, *supra* note 2, at III-1.

10. *Id.* at III-2; *See also* UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 1-106 comment, 8A U.L.A. 445 (1983) which states, “Where a minor has only a small amount of property, it would be wasteful to require protective proceedings to deal with the property.”

11. Gordon, *supra* note 2, at III-2.

12. *Id.*

13. IND. CODE § 29-3-3-1(a) (1988).

14. UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT, 8A U.L.A. 440 (1983).

15. *Id.* § 1-106, 8A U.L.A. 444.

16. *See* IND. CODE § 29-1-18-50 (repealed effective July 1, 1989).

minor . . . after payment of reasonable medical expenses, hospital bills, attorney's fees and other expenses incidental to the collection of any claim due the minor."<sup>17</sup> In contrast, the NGC's \$3,500 threshold relates to any debt or property belonging to a minor,<sup>18</sup> and not to the minor's entire estate. In this context, the NGC has adopted the transactional approach of the Uniform Act which makes it possible for other persons to handle the less complicated property affairs of a minor.<sup>19</sup> While prior Indiana law was couched in terms such as "whole estate,"<sup>20</sup> some commentators believed that the \$3,500 limit under prior Indiana law related not to the size of the minor's estate, but rather the size of the indebtedness to the minor.<sup>21</sup> Thus, the difference between the NGC and prior Indiana law might not be as significant as it first seems.

For the payment of amounts not exceeding \$3,500, these NGC facility of payment provisions are permissive; not mandatory.<sup>22</sup> Accordingly, there may be situations in which the establishment of a full guardianship or some other form of protective proceeding might be beneficial, even for such small amounts.<sup>23</sup> Conversely, for payment of amounts that exceed \$3,500, these NGC facility of payment provisions do not apply and some form of court authorization for the transfer should be obtained.<sup>24</sup>

Under the NGC, the person authorized to receive the payment of debt or delivery of property is "any person having the care and custody

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17. *Id.* These provisions recognize that a minor might not have assets of great value because he has not accumulated assets due to his age. While he might be in need of assistance concerning his financial affairs, a full guardianship or other protective proceedings would be too costly relative to the size of the minor's estate. See Gordon, *supra* note 2, at III-1.

18. IND. CODE § 29-3-3-1(a) (1988).

19. UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 1-106 comment, 8A U.L.A. 445 (1983).

20. See IND. CODE § 29-1-18-50 (repealed effective July 1, 1989).

21. Shivey, *Guardianships* (preface to IND. CODE ANN. § 29-1-18) (West 1979) (The settlement of a claim of a minor by the minor's parents and an insurance company when the claim does not exceed \$3,500 after the payment of reasonable medical expenses, attorney fees and other collection costs does not require a guardianship.).

22. IND. CODE § 29-3-3-1 (1988) (The transferor *may* pay the debt or deliver the property without the appointment of a fiduciary, giving of bond, or other court order to other persons.).

23. One example would be protecting the minor's assets from the creditors of the transferee. Arguably, even though IND. CODE § 29-3-3-1(b) (1988) provides that the person receiving the property has the duty to apply the property to support, use, and benefit of the minor, the property will not be held in the minor's name, but rather the transferee's name and thus the property could be subject to the transferee's creditors.

24. See UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 1-106 comment, 8A U.L.A. 445 (1983) ("Protective proceedings, including the possible establishment of a [guardianship], should be sought where substantial property is involved.").



of the minor with whom the minor resides”<sup>25</sup> or a “guardian of the minor.”<sup>26</sup> In contrast, in addition to these recipients, the Uniform Act also permits payment to the minor if eighteen or more years of age or married<sup>27</sup> or to “a financial institution incident to a deposit in a state or federally insured savings account or certificate in the sole name of the minor with notice of the deposit to the minor.”<sup>28</sup> These differences are not significant, especially when considering that the NGC definition of “minor” is “an individual who is less than eighteen years of age.”<sup>29</sup> Thus, under the NGC, by definition, a minor cannot be eighteen or more years of age.

A person who, in good faith, pays or delivers property in accordance with the NGC’s facility of payment provisions is not responsible for the proper application of that property.<sup>30</sup> Once the proper recipient has received the payment of debt or delivery of property, such recipient has a duty “to apply the property to the support, use and benefit of the minor.”<sup>31</sup> This provision is more liberal than prior Indiana law which required court approval for any application of the property.<sup>32</sup> Yet, this provision might be too liberal because the terms “use” and “benefit” grant the recipient extremely broad discretion in the application of such funds<sup>33</sup> and are not extremely useful terms in creating a standard of care for the recipient. In addition, the NGC’s standard of care fails to provide the duty to preserve and maintain the minor’s assets and the

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25. IND. CODE § 29-3-3-1(a)(1) (1988).

26. *Id.* § 29-3-3-1(a)(2).

27. UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 1-106(a)(1), 8A U.L.A. 444 (1983).

28. *Id.* § 1-106(a)(4), 8A U.L.A. 444.

29. IND. CODE § 29-3-1-10 (1988); *see also* text accompanying note 7.

30. IND. CODE § 29-3-3-1(c) (1988). One suggested approach that a transferor may use to ensure protection under this facility of payment provision is to obtain a receipt in affidavit form. *See* Gordon, *supra* note 2, at III-5 - III-6.

31. IND. CODE § 29-3-3-1(b) (1988).

32. IND. CODE § 29-1-18-50(a) (1979) provided, “The person receiving such money or other assets shall hold and dispose of the same in such manner as the court shall direct.”

33. The Uniform Act specifically rejects such a broad standard and requires that the funds be used for the “support and education” of the minor. *See* UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 1-106(c), 8A U.L.A. 444-45 (1983). In addition, UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 1-106 comment, 8A U.L.A. 445 (1983) provides:

This section does not go as far as many facility of payment provisions found in trust instruments, which usually permit application of sums due a minor beneficiary to any expense or charge for the minor. It was felt that a grant of so large an area of discretion to any category of persons who might owe funds to a minor would be unwise.

duty to turn the remaining assets over to the minor upon attaining majority.<sup>34</sup>

A transferor may not avail himself to the NGC's facility of payment procedures if the transferor "knows that a guardian has been appointed for the minor or that proceedings for appointment of a guardian for a minor are pending."<sup>35</sup> In these situations, because court proceedings are currently in process, the primary purpose of the NGC's facility of payment procedures (*i.e.*, to avoid a full guardianship or other court proceedings) is not applicable. Accordingly, the transfer of assets should be made in conjunction with the pending proceedings.<sup>36</sup> Yet, this limitation seemingly contradicts the NGC's provision which enables a transferor to pay debt or deliver property to a guardian of the minor,<sup>37</sup> and the provisions which enable a guardian to receive property payable to the minor<sup>38</sup> or protected person.<sup>39</sup> This apparent contradiction is probably the result of the Uniform Act's distinction between a guardian and conservator,<sup>40</sup> which historically has not been followed in Indiana.<sup>41</sup> The Uniform Act's comparable provision prohibits the use of the facility of payment procedures for the transfer of a minor's assets if the transferor knows that a conservator has been appointed for the minor or that proceedings for appointment of a conservator are pending.<sup>42</sup> Yet, the Uniform Act permits the application of the facility of payment procedures

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34. *Contra*, UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 1-106(c), 8A U.L.A. 444-45 (1983) which provides, "Any excess sums must be preserved for future support and education of the minor and any balance not so used and any property received for the minor must be turned over to the minor when majority is attained."

35. IND. CODE § 29-3-3-1(c) (1988).

36. Gordon, *supra* note 2, at III-5.

37. *See* IND. CODE § 29-3-3-1(a)(2) (1988); *see also* Gordon, *supra* note 2, at III-5 (suggesting that due to this contradiction, "there appears to be no need for the [NGC] to allow transfers of small amounts to a guardian of the minor as provided in I.C. § 29-3-3-1(a)(2)").

38. *See* IND. CODE § 29-3-8-2(a)(1) (1988).

39. *See* IND. CODE § 29-3-8-4(1) (1988). *See supra* note 3 (noting that a "protected person" is defined in IND. CODE § 29-3-1-13 (1988) as "an individual for whom a guardian has been appointed or with respect to whom a protective order has been issued"). As such, a minor may also be a protected person.

40. Under the Uniform Act, guardianship proceedings affecting minors are described in Article II, Part 1, while a conservator comes into existence incident to the protective proceedings as described in Article II, Part 3.

41. *See* Shivey, *supra* note 21, which states that the term "conservator" may be used interchangeably with the term "guardian." *See also* IND. CODE § 29-3-1-6 (1988) which defines "guardian" as "a person who is a fiduciary and is appointed by a court to be a guardian or *conservator* responsible as the court may direct for the person or the property of a disabled person or a minor." *Id.* (emphasis added).

42. UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 1-106(b), 8A U.L.A. 444 (1983).



in spite of a transferor's knowledge that a guardian of the minor has been appointed or may be appointed as a result of a pending proceeding.<sup>43</sup> Under the Uniform Act, a guardian's powers do not include the authority to compel payment of money due to the minor, but include authority to receive payments made under the protection of the Uniform Act's facility of payment provisions.<sup>44</sup> In contrast, under the Uniform Act, a conservator has title to all assets of the minor's estate, except as otherwise provided in the case of a limited conservator.<sup>45</sup> Because the appointment of a conservator under the Uniform Act is a serious matter affecting the title to the minor's assets, this limitation to the Uniform Act's facility of payment provisions was created.<sup>46</sup> Unlike the Uniform Act, the NGC does not provide for the title of the minor's assets to be transferred to a conservator or guardian.<sup>47</sup> Thus, the rationale for such a limitation on the facility of payment provisions does not exist under the NGC. In sum, this limitation should be rendered to have no effect because the NGC provides that a transferor may pay debts or deliver property to a guardian of a minor without a court order,<sup>48</sup> and that a guardian has the power to receive such property which is payable to the minor.<sup>49</sup>

2. *Disabled Persons*.<sup>50</sup>—Unlike the Uniform Act, the NGC contains facility of payment provisions for disabled persons when the entire

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43. *Id.* § 1-106 comment, 8A U.L.A. 445.

44. *Id.* § 2-109, 8A U.L.A. 467.

45. *Id.* § 2-319, 8A U.L.A. 503.

46. *Id.* § 1-106 comment, 8A U.L.A. 445.

47. *See supra* note 38 and accompanying text.

48. *See supra* note 35 and accompanying text.

49. *See supra* note 37 and accompanying text.

50. IND. CODE § 29-3-1-4 (1988) defines "disabled person" as an individual who:  
(1) cannot be located upon reasonable inquiry;

(2) is unable:

(A) to manage in whole or in part the individual's property;

(B) to provide self-care; or

(C) both;

because of insanity, mental illness, mental deficiency, physical illness, infirmity, habitual drunkenness, excessive use of drugs, incarceration, confinement, detention, duress, fraud, undue influence of others on the individual, or other disability; or

(3) has a developmental disability, the severity and chronicity of which:

(A) is attributable to a mental impairment or physical impairment, or both;

(B) is manifested before the person is twenty-two (22) years of age;

(C) is likely to continue indefinitely;

(D) results in substantial functional limitations in at least three (3) of the following:

(i) self-care;

(ii) receptive and expressive language;

(iii) learning;

property of the disabled person does not exceed \$3,500.<sup>51</sup> These provisions are essentially the same as prior Indiana law<sup>52</sup> with the exception that the NGC's term "entire property" replaces the term "whole estate," because the term "property" more correctly describes the facility of payment for disabled persons than does the term "estate."<sup>53</sup>

### B. Parental Powers

Under prior Indiana law, the parents of a minor were jointly deemed to be the natural guardians of the minor; except as otherwise determined in a divorce or other proceeding. In addition, a parent could not be the natural guardian if the parent was incompetent or if the child was married.<sup>54</sup> The parents, as natural guardians, were given the powers and subject to the limitations imposed upon guardians under prior Indiana law without the need for any court proceeding.<sup>55</sup> The NGC retains the same listing of situations where parental powers are limited as existed under prior Indiana law.<sup>56</sup> Yet, the NGC differs from prior law because the NGC does not grant the parents the general powers of guardians and related limitations.<sup>57</sup> Instead, the NGC provides that parents have two specified powers: the right to custody of the person of a minor and the power to execute certain documents.<sup>58</sup> Yet, the NGC does not specifically define the rights relating to the custody of the person of a

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- (iv) mobility;
  - (v) self-direction;
  - (vi) capacity for independent living; and
  - (vii) economic self-sufficiency; and

(E) reflects the person's need for a combination and sequence of special, interdisciplinary, or generic care, treatment, or other services that are of lifelong or extended duration and are individually planned and coordinated.

51. IND. CODE § 29-3-3-2 (1988).

52. See IND. CODE § 29-1-18-59(b) (repealed effective July 1, 1989).

53. See Gordon, *supra* note 2, at III-7, which states that the term "estate" in the Probate Code, IND. CODE § 29-1-1-3 (1988), denotes the real and personal property of a decedent or ward. Under the facility of payment provisions, there is no decedent and there may not be a ward if full guardianship proceedings have not been implemented.

54. IND. CODE § 29-1-18-5 (repealed effective July 1, 1989).

55. *Id.* § 29-1-18-5.

56. *Id.* § 29-3-3-3 (1988) provides for parental powers: (1) "except as otherwise determined in a dissolution of marriage proceeding or in some other proceeding authorized by law, including a guardianship proceeding;" or (2) unless a minor is married; and (3) if the parent is not a disabled person. It is important to note that dissolution decrees should specifically state who has these powers; otherwise, both parents may be required to perform the necessary action.

57. See *supra* note 53 and accompanying text.

58. IND. CODE § 29-3-3-3 (1988). This provision has no counterpart in the Uniform Act.



minor<sup>59</sup> or the term "custody." In addition, the NGC provides that parents have the power to execute, on the behalf of the minor, a number of specified documents including tax, probate and medical consents and waivers.<sup>60</sup> Specifically, the NGC grants the parents of a minor the authority to execute, on the minor's behalf, the agreement with the Internal Revenue Service required under Internal Revenue Code Section 2032A.<sup>61</sup> This agreement is necessary for an executor to make the election to value certain classes of real estate used in connection with a farm or a closely-held business at their "current" use rather than the usual "highest," "best" or "most suitable" use for estate tax valuation purposes.<sup>62</sup> This election may reduce the size of a decedent's estate by \$500,000 and is primarily designed to prevent the potential problem that a portion of the family farm or business might have to be sold to pay estate taxes.<sup>63</sup> In addition, parents may execute, on the minor's behalf, the consent required by Internal Revenue Code Section 6324A(e) which attaches a lien against certain property to secure payment of the taxes deferred under Internal Revenue Code Section 6166.<sup>64</sup> This provision of the Internal Revenue Code provides for a fifteen-year installment payout with a five-year deferral of estate taxes attributable to the inclusion in the decedent's gross estate of certain qualifying farms or closely-held businesses.<sup>65</sup>

Moreover, parents may, on the behalf of minors, sign the minor's federal and state income tax returns.<sup>66</sup> With the advent of the "kiddie tax,"<sup>67</sup> more minors under the age of fourteen will be required to file income tax returns. Accordingly, this provision will be beneficial in the preparation of the minors' income tax returns because parents may sign for the minors. In addition, parents may execute, on the behalf of a minor, "any other consents, waivers or powers of attorney provided for under the Internal Revenue Code"<sup>68</sup> or provided for under any statute, including the Indiana inheritance tax law, the Indiana gross income tax law and the Indiana adjusted gross income tax law.<sup>69</sup>

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59. Gordon, *supra* note 2, at III-11.

60. IND. CODE § 29-3-3-3 (1988).

61. See Rev. Proc. 81-14, 1981-1 C.B. 669.

62. I.R.C. § 2032A (1986).

63. WEST'S FEDERAL TAXATION: CORPORATIONS, PARTNERSHIPS, ESTATES AND TRUSTS 586 (1981).

64. IND. CODE § 29-3-3-3(2) (1988).

65. I.R.C. § 6166 (1986).

66. IND. CODE § 29-3-3-3(7) (1988).

67. I.R.C. § 1(i) (1986).

68. IND. CODE § 29-3-3-3(3) (1988).

69. *Id.* § 29-3-3-3(5).

For probate purposes, parents are authorized to execute any waiver of notice relating to proceedings under the Indiana Probate Code.<sup>70</sup> In addition, parents are specifically authorized to sign the consent to unsupervised administration under the Indiana Probate Code<sup>71</sup> in situations where a minor is a beneficiary of the estate.

Under the NGC, parents are also authorized to consent to medical or other professional care, treatment or advice for the minor's health and welfare.<sup>72</sup> Yet, under certain circumstances, this parental power may contradict the emancipated minor's right to consent to his own health care needs under the Indiana Health Care Consent Law.<sup>73</sup>

### C. Temporary Guardianships

The NGC provision relating to the appointment of temporary guardians<sup>74</sup> has no counterpart in the Uniform Act, but is similar to prior Indiana law.<sup>75</sup> There are four prerequisites for the appointment of an emergency temporary guardian: a guardian has not been appointed;<sup>76</sup> an emergency exists;<sup>77</sup> the welfare of the disabled person or minor requires immediate action;<sup>78</sup> and no other person appears to have authority to act in the circumstances.<sup>79</sup> These NGC prerequisites for the appointment of an emergency temporary guardian are more specific than under prior Indiana law which simply provided that the court need only find that the welfare of an incompetent required the immediate appointment of a guardian of his person or of his estate.<sup>80</sup> For minors, this NGC provision may apply only in those rare situations where parental powers are limited,<sup>81</sup> because the minor's parents have the right to custody of the person of a minor and the power to execute certain documents, including in particular, a consent to medical treatment.<sup>82</sup> At least arguably, these powers possessed by a minor's parents would prevent the

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70. *Id.* § 29-3-3-3(4). One suggested use of this power is for the parents to sign the waiver of the notice of the hearing on petition to sell real property in the decedents estate coupled with the parents' signing of the consent to the sale of such property. See Gordon, *supra* note 2, at III-13.

71. IND. CODE § 29-3-3-3(6) (1988).

72. *Id.* § 29-3-3-3(8).

73. *Id.* § 16-8-12-2.

74. *Id.* § 29-3-3-4.

75. See *id.* § 29-1-18-24 (repealed effective July 1, 1989).

76. *Id.* § 29-3-3-4(a)(1) (1988).

77. *Id.* § 29-3-3-4(a)(2).

78. *Id.* § 29-3-3-4(a)(3).

79. *Id.* § 29-3-3-4(a)(4).

80. *Id.* § 29-1-18-24 (repealed effective July 1, 1989).

81. See *supra* note 54 and accompanying text.

82. IND. CODE § 29-3-3-3 (1988).



appointment of an emergency temporary guardian because the parents appear to have the authority to act in the circumstances.<sup>83</sup>

While any person may file a petition for the appointment of an emergency temporary guardian, the court, on its own motion, may also appoint an emergency temporary guardian.<sup>84</sup> The court may specify the period of appointment, not to exceed sixty days, for an emergency temporary guardian.<sup>85</sup> Generally, no appointment can be made prior to a hearing on the matter in which the NGC's notice requirements<sup>86</sup> have been satisfied.<sup>87</sup> Yet, the notice requirements may be waived if the court finds that "immediate and irreparable injury to the person, or injury, loss or damage to the property of the alleged disabled person or minor may result before the alleged disabled person or minor can be heard in response to the petition."<sup>88</sup> To protect the alleged disabled person or minor, the NGC provides that they may file a petition to terminate the emergency temporary guardianship or to modify the court order in those situations when notice was waived, in which the court must hear and determine the petition "at the earliest possible time."<sup>89</sup>

In addition, "if the proceeding is for the appointment of a temporary guardian of the person for an alleged disabled person or minor who is in need of medical care," then venue for the proceeding is in the county where the facility providing or attempting to provide medical care is located.<sup>90</sup> This provision is designed to provide flexibility in managing emergency situations that involve health care needs.<sup>91</sup>

A court may also appoint a replacement temporary guardian if the court finds that a previously appointed guardian is not effectively performing his fiduciary duties and that the welfare of the protected person requires immediate action. In these situations, the court may suspend the authority of the previously appointed guardian during the period of time in which the replacement temporary guardian has authority to act.<sup>92</sup>

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83. An example in which this prerequisite might prevent the appointment of a temporary guardian is in situations involving health care decisions if a person has the authority to act under Indiana's Health Care Consent Law (IND. CODE § 16-8-12-1 to -12) (1988)); see Gordon, *supra* note 2, at III-17.

84. IND. CODE § 29-3-3-4(a) (1988).

85. *Id.*

86. See *id.* § 29-3-6-1(a)(2); see also *infra* notes 172-79 and accompanying text.

87. IND. CODE § 29-3-3-4(a) (1988).

88. *Id.*

89. *Id.*

90. *Id.* § 29-3-2-2(a)(1)(B). Otherwise, venue is in the county where the alleged disabled person or minor resides. *Id.* § 29-3-2-2(a)(1)(A).

91. Wishard, *Overview: Indiana's New Guardianship Code*, ICLEF GUARDIANSHIP SEMINAR II-5 (1988).

92. IND. CODE § 29-3-3-4(b) (1988).

In this regard, the court has absolute discretion to determine the period for which the replacement temporary guardian has authority to act and is not limited to the sixty-day period relating to an emergency temporary guardian. The notice requirements for a replacement temporary guardian are the same as for an emergency temporary guardian.<sup>93</sup>

Similar to prior Indiana law,<sup>94</sup> the emergency and replacement temporary guardians have only the responsibilities and powers that are ordered by the court.<sup>95</sup> While the temporary guardianship proceedings are not subject to the NGC's provisions concerning protective order or regular guardianship proceedings,<sup>96</sup> the temporary guardianship proceedings may be joined with such other proceedings.<sup>97</sup> In this context, the temporary guardianship provisions are useful in bridging the gap between the time that a problem is recognized and the time in which a guardian is appointed or a protecting order is issued.<sup>98</sup>

#### *D. Protective Proceedings and Single Transactions*

A protective proceedings is "a proceeding for a protective order."<sup>99</sup> Likewise, a court may treat a proceeding for the appointment of a guardian as one for a protective order if the court finds that it is "not in the best interest of the disabled person or minor" to appoint a guardian.<sup>100</sup> While prior Indiana law had no similar provisions concerning

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93. IND. CODE § 29-3-6-1(a)(2) (1988) provides that if the petition is for the appointment of a temporary guardian (which includes a replacement temporary guardian), notice shall be given as required by IND. CODE § 29-3-3-4(a) which relates to emergency temporary guardians.

94. IND. CODE § 29-1-18-24 (repealed effective July 1, 1989) provides, "The appointment may be to perform specific duties respecting specific property or to perform particular acts, as stated in the order of appointment. The temporary guardian shall make such reports as the court shall direct, and shall account to the court upon termination of his authority."

95. IND. CODE § 29-3-3-4(c) (1988). Gordon, *supra* note 2, at III-19 recommends:

For the emergency temporary guardian, the court should be asked to grant all powers that may be necessary to deal with the existing emergency and any other matter that might arise during the specified period of appointment which would require action for the welfare of the disabled person or minor. For a substitute temporary guardian, the request should be for all powers that the previously appointed guardian had which might be necessary during the period of the temporary guardianship fixed by the court.

96. IND. CODE § 29-3-3-4(d) (1988).

97. *Id.* § 29-3-3-4(e) (1988).

98. For example, a petition for the appointment of a replacement temporary guardian may be joined with a petition for the appointment of a successor guardian under IND. CODE § 29-3-12-4 (1988).

99. IND. CODE § 29-3-1-14 (1988).

100. *Id.* § 29-3-5-3(c).



protective proceedings,<sup>101</sup> the NGC's provisions are similar to those of the Uniform Act.<sup>102</sup>

Any person may petition the court for the issuance of a protective order.<sup>103</sup> The procedure to initiate a protective order involves the same hearing and notice requirements involved with the procedure for requesting the appointment of a guardian.<sup>104</sup> The disabled person's or minor's rights at the hearing concerning the issuance of a protective order are the same as their rights at a hearing concerning the appointment of a guardian.<sup>105</sup>

In addition, except for minors, for a protective order to be issued for the benefit of a person, the court must first determine that the person is a disabled person.<sup>106</sup> The court must also find that the disabled person or minor "owns property or has income requiring management or protection that cannot otherwise be provided; . . . has or may have financial affairs that may be jeopardized or impaired; or . . . has property that needs to be managed to provide for the support or protection of the disabled person" or minor and that "the protection sought is necessary."<sup>107</sup> In addition, while not required for minors, the court must also find that the disabled person is unable to manage his property and financial or business affairs effectively.<sup>108</sup>

Upon making these findings, the court has extremely broad authority to make the orders it considers proper and appropriate to protect the person, business affairs and property of the disabled person or minor.<sup>109</sup> In addition, the court may also, without appointing a guardian, declare the person to be a protected person<sup>110</sup> and authorize or ratify any single transaction necessary and desirable to meet the needs of the protected person.<sup>111</sup> The NGC provides a non-exhaustive list of protective ar-

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101. Matthews, *Protective Proceedings and Single Transactions*, ICLEF GUARDIANSHIP SEMINAR IV-1 (1988).

102. See UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 2-301, 8A U.L.A. 488-89 (1983).

103. IND. CODE § 29-3-4-1(a) (1988).

104. See *infra* notes 172-79 and accompanying text.

105. IND. CODE § 29-3-4-1(c) (1988).

106. *Id.* § 29-3-4-1(a).

107. *Id.* § 29-3-4-1(d), (e).

108. *Id.* § 29-3-4-1(d)(2).

109. *Id.* § 29-3-4-1(d), (e).

110. See *supra* note 3 and accompanying text.

111. IND. CODE § 29-3-4-1(f) (1988). This subsection is substantively the same as the Uniform Act, the official comment of which states:

It is important that the provision be made for the approval of single transactions or the establishment of protective arrangements as alternatives to full conservatorship. . . . This section, consistent with the concept of a limited

rangements that might involve more than one transaction, which includes: the payment, delivery, deposit, or retention of property; the sale, mortgage, lease, or other transfer of property; the entry into an annuity contract, a contract for life care, a deposit contract, or a contract for training and educating a person; and the addition to or establishment of a suitable trust.<sup>112</sup> Even though a court must act in authorizing single transactions and protective arrangements, it acts directly without appointing a guardian and, as a result, the comprehensively disabling effect of appointing a guardian is avoided.<sup>113</sup>

### *E. Limited Guardianships*

Under the NGC, there are two separate methods in which a limited guardian may be appointed. First, a court may appoint a limited guardian to assist in the establishment of any protective arrangement or single transaction.<sup>114</sup> In this context, the limited guardian has the authority conferred by the court order and serves until discharged by the court after reporting to the court all matters conducted under the order.<sup>115</sup> In addition, a limited guardian may be appointed in lieu of a guardian if it is alleged, and the court finds, that the welfare of a disabled person would be best served by limiting the scope of the guardianship.<sup>116</sup> In this context, the court order should be made to encourage the development of the disabled person's self-improvement, self-reliance, and independence and to contribute to the disabled person's living as normal a life as that person's condition and circumstances permit without psychological or physical harm to the disabled person.<sup>117</sup> For this second type of limited guardianship, the NGC provides no guidance as to the powers and duties of the limited guardian or the duration of the limited guardianship. Unlike the NGC, prior Indiana law provided that the powers and duties

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conservatorship, eliminates the necessity of the establishment of long-term arrangements in this situation.

UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS § 2-308(a) comment, 8A U.L.A. 497 (1983).

112. IND. CODE § 29-3-4-1(f) (1988); see also Matthews, *supra* note 101, at IV-3 - IV-4. The author, in discussing the parameters of the term "suitable trust," states that the NGC does not specifically provide for the automatic termination of a trust established for the benefit of a minor upon the minor reaching the age of eighteen years of age. Although theoretically possible under the NGC, a trust of unlimited duration, established for the benefit of a minor who is not also disabled, which extends majority would probably be an unconstitutional taking of the minor's property.

113. Emison, *supra* note 6, at X-7.

114. IND. CODE § 29-3-4-3 (1988).

115. *Id.*

116. *Id.* § 29-3-5-3.

117. *Id.*



of the limited guardian should be specifically stated in the order of appointment, and that such powers and duties should not extend beyond what was prescribed in the order of appointment.<sup>118</sup> Under prior Indiana law, the ward retained all other rights, powers and duties.<sup>119</sup> Yet, in the NGC, no such guidance exists and practitioners are free to recommend and courts are free to formulate specific powers and duties in the orders of appointment. With such lack of direction from the NGC, it is not unexpected for practitioners to hesitate establishing a limited guardianship in lieu of a full guardianship or a protective proceeding.<sup>120</sup> Thus, the sparse language in the NGC might have the unintended result of discouraging limited guardianships.

The concept of limited guardianships has developed as a response to the traditional absolute authority granted to a guardian as well as recent insights into the nature of disabilities and the possibilities for rehabilitation and treatment when a protected person has control over his affairs.<sup>121</sup> As such, a limited guardianship is of particular significance to developmentally-impaired individuals.<sup>122</sup> The premise of the use of a limited guardianship in this regard is that a developmentally impaired person grows and develops with training. As the person develops, the limited guardianship can be further limited with the intent of its eventual termination.<sup>123</sup> In most states with limited guardianship statutes, the court must initially determine those areas of decisionmaking in which a disabled person is incapacitated.<sup>124</sup> The use of an individual functional assessment questionnaire is helpful in making such an assessment, because it is designed to identify functional limitations and to determine whether the limitations result in an inability to provide informed decisions on issues of legal significance.<sup>125</sup> Based upon such an assessment, the court may grant authority to the limited guardian in those areas of decisionmaking in which evidence indicates that the disabled person is incapacitated.<sup>126</sup>

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118. *Id.* § 29-1-18-21 (repealed effective July 1, 1989).

119. *Id.*

120. Emison, *supra* note 6, at X-8. Emison suggests that a petitioner is probably better advised to use protective proceedings rather than "this newly-stated version of a limited guardianship."

121. Casasanto, Saunders & Simon, *Individual Functional Assessment: A Guide to Determining the Need for Guardianship under New Hampshire Law*, 28 NEW HAMPSHIRE B.J. 13, 14-15 (1986) [hereinafter Casasanto].

122. See Secor, Parra, Schklar, Fosbinder & Brown, *Use of Limited Guardianship Proceedings for Disabled Persons*, 18 TENN. B.J. 14 (May 1982).

123. *Limited Guardianship: Survey of Implementation Considerations*, 15 REAL PROP. PROB. & TR. J. 544 (1980).

124. Casasanto, *supra* note 121, at 15.

125. *Id.* at 13-14 (The authors provide an individual functional assessment questionnaire and instruction manual.).

126. *Id.* at 15.

For example, a limited guardian may only have the authority to make decisions concerning medical treatment.<sup>127</sup>

Similar to protective proceedings and single transactions, a limited guardianship eliminates the necessity of the establishment of a full guardianship. Yet, there are differences between these alternatives to full guardianships. For instance, protective proceedings and single transactions focus on specific transactions of a disabled person,<sup>128</sup> while limited guardianships focus more on routine decisions made for a disabled person.<sup>129</sup> In addition, protective proceedings and single transactions involve direct court authorization or ratification of the transaction,<sup>130</sup> while limited guardianships involve the granting of authority to the limited guardian to make decisions in limited areas on behalf of the disabled person.<sup>131</sup> As previously stated, a limited guardian may be appointed by a court to assist in the establishment of any protective arrangement or single transaction.<sup>132</sup> In such a situation, the limited guardian's authority is limited to that conferred by the court order,<sup>133</sup> and because the court has directly authorized the underlying transaction, the limited guardian's authority would seem to be administrative in nature.

#### *F. Other Alternatives to Guardianships*

Under prior Indiana law, not all forms of protection of a disabled person or a minor were included in the guardianship law. While the NGC expands the number of alternatives in the guardianship law itself, other statutory alternatives outside the guardianship law still exist. One of the most notable examples is the Uniform Durable Power of Attorney Act.<sup>134</sup> A durable power of attorney differs from the common law power of attorney because a durable power of attorney may permit the agency relationship to continue after the subsequent disability or incapacity of

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127. *Id.* Other common areas identified by the authors concerning a limited guardian's authority to act include: travel, or decision where to live; refusal or consent to counseling services or other professional care where consent is legally necessary; making contracts; possessing or managing real or personal property or income from any source; making gifts; initiating, defending or settling lawsuits; lending or borrowing money; paying or collecting debts; managing a business; continuing to act as a partner of a partnership; accessing or releasing confidential records; and making decisions concerning education.

128. *See supra* notes 107-08 and accompanying text.

129. *See supra* note 123 and accompanying text.

130. IND. CODE § 29-3-4-1(f) (1988).

131. *See supra* note 122 and accompanying text.

132. *See supra* note 100 and accompanying text.

133. *See supra* note 111 and accompanying text.

134. IND. CODE § 30-2-11-1 to -7 (1988).



the principal or lapse of time.<sup>135</sup> In addition, the Uniform Durable Power of Attorney Act provides that the death of a principal who has executed a power of attorney, durable or otherwise, may not terminate the agent's authority until the agent has actual knowledge of the principal's death.<sup>136</sup> Furthermore, another salient feature of the Uniform Durable Power of Attorney Act is that it permits a person to nominate by a durable power of attorney his own guardian, and except for good cause or disqualification, the court must make its appointment in accordance with the person's most recent nomination.<sup>137</sup>

Another statutory alternative to a guardianship is the Indiana Uniform Gifts to Minors Act.<sup>138</sup> This Act creates a statutory trust with a support, maintenance, education and benefit standard for distribution.<sup>139</sup> The custodian has broad discretion to make such distributions without the need for court approval.<sup>140</sup> In addition, the custodian has all of the rights and powers of a guardian.<sup>141</sup> The duration of an Indiana Uniform Gift to Minors Act custodianship is limited to when the donee reaches the age designated by the donor which cannot be less than eighteen or greater than twenty-one years of age.<sup>142</sup>

An inter vivos trust is another alternative to a guardianship. The inter vivos trust, which separates legal title from beneficial title, can be an extremely powerful and flexible tool, albeit expensive.<sup>143</sup> Some of this expense can be deferred by postponing all but nominal funding until disability of the grantor-beneficiary occurs.<sup>144</sup> This standby arrangement requires the grantor to have also executed a durable power of attorney prior to disability for the purpose of funding the trust.<sup>145</sup>

Another alternative to a full guardianship is contained in the Model Health Care Consent Act.<sup>146</sup> Without court supervision, an individual, who is able to consent to particular health care, may appoint another person to act for him in the future if he becomes incapable of consenting.<sup>147</sup> This provision is designed to permit a person to plan who

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135. *Id.* § 30-2-11-1.

136. *Id.* § 30-2-11-4(a).

137. *Id.* § 30-2-11-3.

138. *Id.* § 30-2-8-1 to -10.

139. *Id.* § 30-2-8-4(b).

140. *Id.*

141. *Id.* § 30-2-8-4(j).

142. *Id.* § 30-2-8-2.5(g).

143. Emison, *supra* note 6, at X-11.

144. *Id.*

145. *Id.* The author further explains that a standby trust coupled with a durable power of attorney might not be the best tool to provide for the personal care needs of a person.

146. IND. CODE § 16-8-12-1 to -12 (1988).

147. *Id.* § 16-8-12-6.

shall serve as a representative in health care decisions during future incapability. A person becomes incapable of consent if, "in the good faith opinion of the attending physician, the individual is incapable of making a decision regarding the proposed health care."<sup>148</sup> If an attending physician makes this determination concerning a person who has appointed a health care representative under the Model Health Care Consent Act, then that representative has the authority to make health care decisions according to the terms of the appointment, until such time that the person becomes capable of consenting.<sup>149</sup> In addition, if an attending physician makes this determination concerning a person who has not appointed a health care representative and who has no judicially appointed guardian, then the Model Health Care Consent Act provides that a "spouse, parent, adult child or adult sibling" may consent to health care.<sup>150</sup> Resort to a probate court is also available under the Model Health Care Consent Act for the court to make a health care decision, to order health care for an individual incapable of consenting, or to appoint a health care representative for that individual.<sup>151</sup> The Model Health Care Consent Act also permits an individual to disqualify others from consenting to the individual's future health care.<sup>152</sup>

### III. GUARDIANSHIPS

#### A. *Jurisdiction and Venue*

Similar to prior Indiana law, the NGC provides that the court having probate jurisdiction<sup>153</sup> has exclusive original jurisdiction over all matters concerning guardians and protective proceedings.<sup>154</sup> The NGC provides two exceptions to a probate court's exclusive jurisdiction:<sup>155</sup> where "a juvenile court has exclusive original jurisdiction over certain matters relating to minors;"<sup>156</sup> and where "a mental health division of a municipal court . . . has concurrent jurisdiction in certain mental health proceedings

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148. *Id.* § 16-8-12-3(a).

149. *Id.* § 16-8-12-6(g).

150. *Id.* § 16-8-12-4(a).

151. *Id.* § 16-8-12-7.

152. *Id.* § 16-8-12-8.

153. IND. CODE § 29-3-1-3 (1988) defines "court" as the "court having probate jurisdiction and, where the context permits, the court having venue of the guardianship."

154. *Id.* § 29-3-2-1; *see also id.* § 29-1-18-4 (repealed effective July 1, 1989) for prior Indiana law.

155. *Id.* § 29-3-2-1(c), (d).

156. IND. CODE § 31-6-2-1 (1988) provides that a juvenile court has exclusive jurisdiction in all cases concerning a child's alleged delinquency, dependency or neglect. *See also In re Guardianship of Bramblett*, 495 N.E.2d 798 (Ind. Ct. App. 1986); *In re Guardianship of Neff*, 456 N.E.2d 1045 (Ind. Ct. App. 1983).



... relating to guardianships and protective orders.”<sup>157</sup>

If the alleged disabled person or minor resides in Indiana, then venue for the appointment of a guardian or for protective proceedings is generally in the county of that person’s residence.<sup>158</sup> If the alleged disabled person or minor does not reside in Indiana, then venue is in any county where any property of the person is located.<sup>159</sup> As previously stated, if the proceeding is for the appointment of a temporary guardian of the person, who is in need of medical care, then venue is in the county where the facility is located that is providing, or attempting to provide medical care, regardless of the person’s residence.<sup>160</sup>

If proceedings are commenced in two or more counties, then the court in which the first proceeding was commenced is to determine proper venue.<sup>161</sup> All other proceedings are stayed.<sup>162</sup> If this court determines that proper venue is in another county, the court must transfer the original file to the proper court.<sup>163</sup> In addition, a court may transfer a guardianship or protective proceeding to another court in Indiana upon the court’s finding of certain conditions<sup>164</sup> or to a court outside Indiana if the other court agrees to assume jurisdiction.<sup>165</sup> This permissive type of transfer requires notice and a hearing in the same manner as is required for the appointment of a guardian.<sup>166</sup> Finally, if a court which appointed a guardian does not have probate jurisdiction, the proceeding must be transferred to the court which has proper jurisdiction and venue.<sup>167</sup>

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157. IND. CODE § 33-6-1-2(a)(8) (1988) provides that the mental health division of a municipal court has concurrent jurisdiction with any other authorized court to declare and administer temporary guardianships in conjunction with mental health proceedings, involuntary mental commitments and voluntary mental commitments.

158. *Id.* § 29-3-2-2(a)(1)(A).

159. *Id.* § 29-3-2-2(a)(2).

160. *Id.* § 29-3-2-2(a)(1)(B), (a)(2); *see also supra* note 90 and accompanying text.

161. IND. CODE § 29-3-2-2(b) (1988).

162. *Id.*

163. *Id.*

164. IND. CODE § 29-3-2-2(c) (1988) lists the conditions in which a court may transfer jurisdiction:

- (1) the proceeding was commenced in the wrong county;
- (2) the residence of the disabled person or the minor has been changed to another county;
- (3) the proper venue is determined to be otherwise under the Indiana Rules of Trial Procedure; or
- (4) it would be in the best interest of the disabled person or the minor and the property of the minor or the disabled person.

165. *Id.* § 29-3-2-2(c).

166. *Id.* § 29-3-2-2(c); *see also infra* notes 172-79 and accompanying text.

167. *Id.* § 29-3-2-2(d). While this NGC subsection uses the term “probate juris-

### B. Appointment of Guardian

A guardianship is commenced when a person files a petition for the appointment of a guardian.<sup>168</sup> The petition must contain a number of specific items,<sup>169</sup> all of which are substantially the same items required in a petition under prior Indiana law.<sup>170</sup> Only one petition needs to be filed for the appointment of a guardian for two or more minors or disabled persons who are the children of a common parent, parent and child, or husband and wife.<sup>171</sup>

Service of notice under the NGC<sup>172</sup> is to be given in the same manner prescribed under the Indiana Probate Code with regard to personal service, publication to nonresidents,<sup>173</sup> registered mail, personal service on nonresidents, and service on attorneys.<sup>174</sup> When a petition for appointment of a guardian or the issuance of a protective order relates

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diction," presumably this term also includes juvenile courts and the mental health division of a municipal court, both of which have jurisdiction in certain circumstances pursuant to IND. CODE § 29-3-2-1. See *supra* notes 155-57 and accompanying text.

168. *Id.* § 29-3-5-1. See also Fruehwald, *Appointment of a Guardian*, ICLEF GUARDIANSHIP SEMINAR V-5 (1988).

169. IND. CODE § 29-3-5-1(a) (1988) states that a petition must contain the following:

- (1) The name, age, residence, and post office address of the alleged disabled person or minor for whom the guardian is sought to be appointed.
- (2) The nature of the disability.
- (3) The approximate value and description of the property of the disabled person or minor, including any compensation, pension, insurance, or allowance to which the disabled person or minor may be entitled.
- (4) If a limited guardianship is sought, the particular limitations requested.
- (5) Whether a guardian has been appointed or is acting for the disabled person or minor in any state.
- (6) The residence and post office address of the proposed guardian.
- (7) The names and addresses, as far as known or as can reasonably be ascertained, of the persons most closely related by blood or marriage to the person for whom the guardian is sought to be appointed.
- (8) The name and address of the person or institution having the care and custody of the person for whom the guardian is sought to be appointed.
- (9) The names and addresses of any other disabled persons or minors for whom the proposed guardian is acting if the proposed guardian is an individual.
- (10) The reasons the appointment of a guardian is sought and the interest of the petitioner in the appointment.
- (11) The name and business address of the attorney who is to represent the guardian.

170. *Id.* § 29-1-18-11 (repealed effective July 1, 1989).

171. *Id.* § 29-3-5-6 (1988).

172. *Id.* § 29-3-6-1.

173. See Fruehwald, *supra* note 168, at V-7. The author noted that publication for non-residents should be avoided under a logical extension of the United States Supreme Court's holding in *Tulsa Collection Services v. Pope*, 108 S. Ct. 1340 (1988).

174. See IND. CODE § 29-1-1-12 to -14 (1988).



to a minor, notice of the hearing on the petition must be given to: "the minor, if he is fourteen years or older, unless the minor has signed the petition; . . . any living parent of the minor, unless parental rights have been terminated by court order; . . . any person alleged to have the principal care and custody of the minor during the sixty (60) days immediately preceding the filing of the petition;" and "any other person that the court directs."<sup>175</sup> If it is alleged that the person is a disabled person, notice of the hearing on the petition must be given to: the alleged disabled person; the alleged disabled person's spouse; the alleged disabled person's adult children, or if none, the alleged disabled person's parents; any person serving as the guardian for, or who has the care and custody of, the alleged disabled person; if there is no person to be notified from the above persons other than the alleged disabled person, then at least one person most closely related by blood or marriage to the alleged disabled person; any person known to the petitioner to be serving as the alleged disabled person's attorney-in-fact under a durable power of attorney; and any other person that the court directs.<sup>176</sup> Notice is not required for guardianship and protective proceedings concerning a disabled person if the person to be notified waives notice or appears at the hearing on the petition.<sup>177</sup> In addition, a court may, upon a showing of good cause, waive notice of a petition for the appointment of a successor guardian.<sup>178</sup> Yet, at least arguably, notice cannot be waived for guardianship and protective proceedings relating to minors.<sup>179</sup>

After a petition has been filed, the court is to set a hearing date.<sup>180</sup> Unless an alleged disabled person is represented by counsel, a court may appoint an attorney to represent the alleged disabled person and may grant such attorney the powers and duties of a guardian ad litem.<sup>181</sup> In addition, if a court determines that the alleged disabled person or minor is not represented or adequately represented by counsel, then the court must appoint a guardian ad litem and must set out, as part of the record, the reasons for such appointment.<sup>182</sup> Unlike prior Indiana

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175. *Id.* § 29-3-6-1(a)(3).

176. *Id.* § 29-3-6-1(a)(4).

177. *Id.*

178. *Id.* § 29-3-6-1(a)(1).

179. IND. CODE § 29-3-6-1(a)(4) (1988) provides, "Notice is not required under this *subdivision* if the person to be notified waives notice or appears at the hearing on the petition." (emphasis added) This subdivision only deals with disabled persons and not minors. There appears to be no rationale to prevent waiver of notice to the designated persons for proceedings relating to minors. One wonders whether the word "subsection" should be substituted for the word "subdivision."

180. *Id.* § 29-3-5-1(c).

181. *Id.*

182. *Id.* § 29-3-2-3.

law,<sup>183</sup> the NGC does not define the term “guardian ad litem,” nor does it define the powers and duties of a guardian ad litem. As such, other statutory provisions and related case law must be examined to provide these definitions.<sup>184</sup> An alleged disabled person<sup>185</sup> must be present at the hearing unless the court finds that certain circumstances exist.<sup>186</sup> The alleged disabled person may present evidence and cross-examine witnesses.<sup>187</sup> In addition, a jury trial may be requested.<sup>188</sup> Finally, any person may apply for permission to participate in a hearing if the court determines that the best interest of the alleged disabled person or minor will be so served.<sup>189</sup>

A guardian will be appointed if the court finds that the individual for whom the guardian is sought is a disabled person<sup>190</sup> or a minor and the appointment of a guardian is necessary as a means of providing

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183. IND. CODE § 29-1-18-1(b) (repealed effective July 1, 1989) defined a guardian ad litem as “one appointed by a court, in which particular litigation is pending, to represent a ward or an unborn person in that particular litigation.”

184. See *id.* § 34-2-3-1 (1988); see also *Bowen v. Sonnenburg*, 411 N.E.2d 390, 396 (Ind. Ct. App. 1980) (emphasis in original) (“Guardian ad litem is someone appointed by the court in which a particular litigation is pending to represent a ward or unborn person *in that particular litigation* . . . [and the] status of a guardian ad litem exists [only] in the particular litigation in which the appointment occurs.”); *Ziegler v. Ziegler*, 39 Ind. App. 21, 23, 78 N.E. 1066, 1068 (1906) (quoting *Gibbs v. Potter*, 166 Ind. 471, 475, 77 N.E. 942, 944 (1906) (emphasis in original) (“The extent of the authority of a guardian *ad litem* must be found in the statute authorizing his appointment and in the order of the court made in pursuance thereof.”)).

185. No mention is made of whether or not a minor must be present at the hearing. See *Fruehwald*, *supra* note 168, at V-8.

186. IND. CODE § 29-3-5-1(d) (1988). These circumstances are:

- (1) it is impossible or impractical for the alleged disabled person to be present due to the alleged disabled person’s disappearance, absence from the state, or similar circumstance;
- (2) it is not in the alleged disabled person’s best interest to be present because of a threat to the health or safety of the alleged disabled person as determined by the court;
- (3) the disabled person has knowingly and voluntarily consented to the appointment of a guardian or the issuance of a protective order and at the time of such consent the disabled person was not disabled as a result of a mental condition that would prevent that person from knowingly and voluntarily consenting; or
- (4) the disabled person has knowingly and voluntarily waived notice of the hearing and at the time of such waiver the disabled person was not disabled as a result of a mental condition that would prevent that person from making a knowing and voluntary waiver of notice.

187. *Id.* § 29-3-5-1(e).

188. *Id.*; see IND. R. TR. P. 38 for the time period necessary to request a jury trial.

189. IND. CODE § 29-3-5-3(f) (1988).

190. See *supra* note 50.



care and supervision of the physical person or property of the disabled person or minor.<sup>191</sup> The court may limit the scope of the guardianship if it finds that the welfare of a disabled person would be best served.<sup>192</sup> In addition, if the court finds that it is "not in the best interest of the disabled person or minor to appoint a guardian," the court may treat the petition for guardianship as a protective order or dismiss the proceedings.<sup>193</sup>

Except for minors, the threshold question concerning whether to appoint a guardian is whether or not the person is a disabled person.<sup>194</sup> Except for the use of more modern terms in the NGC, the NGC's definition of a "disabled person" is not materially different from the definition of an "incompetent"<sup>195</sup> under prior Indiana law.<sup>196</sup> As a result, under NGC, a physical condition by itself is sufficient for the appointment of a guardian.<sup>197</sup> Since the NGC is similar to prior Indiana law, the holding in *In re Wurm*<sup>198</sup> may still be applicable. In that case, the court held that the appointment of a guardian must be grounded on a finding that the person is unable to reasonably deal with his business affairs because of mental impairment, albeit with the recognition that mental attributions can be affected by physical disabilities.<sup>199</sup>

### C. Guardians

Similar to prior Indiana law<sup>200</sup> and the Uniform Act,<sup>201</sup> the NGC provides a court with broad discretion in appointing a guardian who is

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191. IND. CODE § 29-3-5-3 (1988).

192. See *supra* notes 116-20 and accompanying text.

193. IND. CODE § 29-3-5-3(c) (1988).

194. See *supra* notes 186-87 and accompanying text.

195. See IND. CODE § 29-1-18-1(c) (repealed effective July 1, 1988).

196. Cremer, *Litigation: Guardianships-Conservatorship*, ICLEF GUARDIANSHIP SEMINAR IX-1 (1988).

197. *Id.* See also *supra* note 50. IND. CODE § 29-2-1-4(3)(A) (1988) clearly provides that disability may be attributable to a mental impairment or physical impairment.

198. 360 N.E.2d 12 (Ind. Ct. App. 1977).

199. *Id.* at 15.

200. IND. CODE § 29-1-18-10 (repealed effective July 1, 1988) provided that the court must appoint a guardian of an incompetent person who is most suitable and willing to serve. See also *In re Guardianship of Brown*, 436 N.E.2d 877 (Ind. Ct. App. 1982) (appointment of guardian is within discretion of trial court which must have ultimate regard for best interests of incompetents).

201. See UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 2-205, 8A U.L.A. 480 (1983) which provides that any qualified person may be appointed guardian of an incapacitated person. This comment to this section further provides that "qualified" in its application to "persons" is not defined in the Uniform Act, meaning that an appointing court has considerable discretion regarding the suitability of an individual to serve as a guardian. *Id.* § 2-205 comment, 8A U.L.A. 481.

qualified and willing to serve.<sup>202</sup> It has been suggested that this broad discretion is limited by the rules relating to the appointment of a personal representative for a decedent's estate.<sup>203</sup> As such, a qualified guardian may also have to be: eighteen years of age or older; competent; not a convicted felon; and, if a resident corporation, qualified to act as a fiduciary in Indiana.<sup>204</sup> Under the NGC,<sup>205</sup> courts should give due regard to the same considerations listed in prior Indiana law regarding the appointment of a guardian.<sup>206</sup> In addition, the NGC provides that a court should give due regard to designations made by an alleged disabled person in a durable power of attorney and to any person acting for the disabled person pursuant to a durable power of attorney<sup>207</sup> executed before the person became disabled.<sup>208</sup> While the court has broad discretion in appointing a guardian, the court should give preference, in the order listed, to: a person designated in a durable power of attorney; the disabled person's spouse; the disabled person's adult child; the disabled person's parent; a person designated in a disabled person's parent's will; any person related to the disabled person by blood or marriage with whom the disabled person has resided for more than six months prior to the filing of the petition; and a person nominated by the disabled

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202. See IND. CODE § 29-3-5-4 (1988).

203. See Fruehwald, *supra* note 168, at V-11. Prior Indiana law provided that persons who are qualified to serve as personal representatives for a decedent's estate are qualified to serve as a guardian. See IND. CODE § 29-1-18-9 (repealed effective July 1, 1989). It does not appear that such provision was carried over into the NGC.

204. IND. CODE § 29-1-10-1(b) (1988).

205. *Id.* § 29-3-5-4.

206. IND. CODE § 29-1-18-10 (repealed effective July 1, 1988) provided that a court should give due regard to:

- (1) any request made by one for whom a guardian is being appointed by reasons of old, age, infirmity, or other incapacity, other than insanity, mental illness, mental retardation, senility, habitual drunkenness, or excessive use of drugs;
- (2) any request for the appointment contained in a will or other written instrument;
- (3) any request made by a minor of the age of fourteen (14) years or over for the appointment of his guardian;
- (4) any request for the appointment made by the spouse of an incompetent;
- (5) the relationship by blood or marriage to the person for whom guardianship is sought;
- (6) the assets or interests of the incompetent and the incompetent's estate.

207. IND. CODE § 29-3-1-5 (1988) defines "durable power of attorney" as a power of attorney that:

- (1) is executed by a disabled person before that person became a disabled person;
- (2) provides that the power survives the person's incompetence; and
- (3) is executed in accordance with the law in effect in the jurisdiction in which it was executed on the date it was executed.

208. *Id.* § 29-3-5-4(1), (6). See also *supra* note 137 and accompanying text.



person who is caring for or paying for the care of the disabled person.<sup>209</sup> The court must select the person it considers best qualified to serve as a guardian when persons who want to be a guardian have equal priority.<sup>210</sup> A court may also act in the best interests of the disabled person or minor by selecting a low or no priority person over a higher priority person.<sup>211</sup> Prior Indiana law specifically included a provision permitting the department of public welfare, any other public agency or any charitable organization which was charged with the care and custody of an incompetent to be appointed as a guardian.<sup>212</sup> The NGC essentially maintained these provisions by including these organizations in its definition of "person"<sup>213</sup> in connection with whom may be appointed a guardian. While these provisions permit a court having probate jurisdiction to appoint such an organization as a guardian for a disabled person, a juvenile court has exclusive jurisdiction to do so for minors.<sup>214</sup>

Similar to prior Indiana law,<sup>215</sup> the NGC requires that a guardian must execute and file a bond.<sup>216</sup> The NGC recognizes two exceptions to this requirement: if the guardian is a bank or trust company;<sup>217</sup> or if the court finds a bond unnecessary and enters an order to that effect.<sup>218</sup> The bond must not be less than the value of the guardianship property in which the guardian has the power to sell, convey or encumber without a court order, plus one year's estimated income.<sup>219</sup> The court may accept

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209. *Id.* § 20-3-5-5(a).

210. *Id.* § 29-3-5-5(b).

211. *Id.*

212. *Id.* § 29-1-18-9 (repealed effective July 1, 1988).

213. IND. CODE § 29-3-1-12 (1988) defines "person" as:

an individual, organization, association, not-for-profit corporation, corporation for profit, partnership, financial institution, trust, department of public welfare or other governmental entity, or other legal entity.

214. *See supra* note 156 and accompanying text. *See also In re Guardianship of Neff*, 456 N.E.2d 1045 (Ind. Ct. App. 1983) (Superior Court's order directing an infant be made a ward of county department of public welfare was improper exercise of court's probate jurisdiction).

215. IND. CODE § 29-1-18-22 (repealed effective July 1, 1989).

216. *Id.* § 29-3-7-1 (1988).

217. IND. CODE § 28-1-1-3(b) (1988) defines "bank or trust company" as:

a financial institution organized or reorganized as a bank, savings bank, private bank, or trust company under the laws of this state with the express power to receive and accept deposits of money subject to withdrawal by check, and possessing such other rights and powers granted by the provisions of this article in express terms or by implication. The term "bank" or "bank or trust company" does not include a building and loan association, credit union, or industrial loan and investment company.

218. *Id.* § 29-3-7-1(a).

219. *Id.*

other collateral, including a pledge of securities or a mortgage of land.<sup>220</sup> In addition, the court has the authority to reduce the amount of the bond provided that the protected person's property is adequately protected.<sup>221</sup> As a condition of the bond reduction, a court may direct the guardian to take specific steps to provide protection of the protected person's property.<sup>222</sup> Where there is a surety on the bond, the NGC provides specific requirements concerning the respective liability of sureties and guardians; consent by the surety to the jurisdiction of the court; notice to sureties; proceedings against a surety for breach of the guardian's duties; and the duration of the obligations under the bond.<sup>223</sup>

Letters of guardianship should be issued only after the bond, if required, and the oath of a guardian have been filed with the clerk of the court.<sup>224</sup> The oath, which must state that the guardian will faithfully discharge the duties of the guardian's trust according to law, must be subscribed before the clerk or any other officer authorized to administer oaths.<sup>225</sup> For corporate guardians, an acceptance of appointment must

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220. *Id.* § 29-3-7-1(b).

221. *Id.* § 29-3-7-1(c).

222. IND. CODE § 29-3-7-1(c) (1988) provides that a court

(1) Direct the guardian to invest all, or a part of, the property subject to the guardian's control in:

(A) stocks, bonds, or other securities of any corporation, public or private, which are listed or admitted to trading on the New York Stock Exchange, the American Stock Exchange, the Midwest Stock Exchange, the Pacific Coast Stock Exchange, or any other exchange regulated by the Securities and Exchange Commission; or

(B) securities that are obligations issued or guaranteed by the United States. . . .

(3) Direct the guardian to transfer all, or a part of, the property subject to the guardian's control to a bank or trust company organized under the laws of Indiana or of the United States and operating a bank or trust company located within Indiana to administer the estate as an agent for the guardian.

(4) Direct the guardian to:

(A) transfer any or all stocks, bonds, and securities subject to the guardian's control only after obtaining an order of the court directing the transfer; and

(B) require that notice of this restriction on the transfer of such stocks, bonds, and securities be placed upon the certificates evidencing those stocks, bonds, and securities.

(5) Direct the guardian to comply with all, part, or any combination of the requisites specified in subdivisions (1) through (4).

(6) Direct the guardian to take any other action that the court determines necessary to provide adequate protection to the property of the protected person.

223. *Id.* § 29-3-7-2(a).

224. *Id.* § 29-3-7-3.

225. *Id.*



be executed and acknowledged by an appropriate corporate officer.<sup>226</sup> In addition, the oath and acceptance, if applicable, must be filed and recorded as part of the guardianship proceedings.<sup>227</sup> Any limitations on a guardian's powers and responsibilities, including the creation of a limited guardianship,<sup>228</sup> must be endorsed on the letters of guardianship.<sup>229</sup> A guardian must use the letters of guardianship as evidence that he has all, and the protected person has none, of the rights to possess and dispose of the guardianship property.<sup>230</sup> The letters of guardianship should be used to provide notice by delivering them to all relevant financial institutions and persons and recording them in counties where real estate is located.<sup>231</sup>

#### *D. Powers and Duties of a Guardian*

Under prior Indiana law, a guardian could be appointed by a court as the guardian of the person or the guardian of the estate,<sup>232</sup> with different types of duties depending on the nature of the guardianship.<sup>233</sup> This dichotomy was not retained in the NGC and, as a result, a guardian has duties concerning both the person and the property of the protected person. A guardian has the right to take possession of the guardianship property and the right to dispose of such property.<sup>234</sup> While the protected person has title to the guardianship property, he is prohibited from transferring or assigning it.<sup>235</sup> The guardian has specified mandatory duties under the NGC which include: to abide by the standards of care and conduct applicable to trustees;<sup>236</sup> the duty to protect and preserve

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226. *Id.*

227. *Id.*

228. *See supra* notes 114-33 and accompanying text.

229. IND. CODE § 29-3-7-3(c) (1988); *id.* § 29-3-8-8(b).

230. *Id.* § 29-3-7-6(a); *see also id.* § 29-3-1-7, which defines "guardianship property" as the property of a disabled person or a minor for which the guardian is responsible.

231. *Id.* § 29-3-7-6(b).

232. *Id.* § 29-1-18-1 (repealed effective July 1, 1988).

233. *Id.* § 29-1-18-28.

234. *Id.* § 29-3-7-5 (1988).

235. *Id.* While an attempted transfer or assignment of guardianship is ineffective, it may generate a claim under IND. CODE § 29-3-10-1 (1988).

236. *See id.* § 30-4-3-6 which provides:

(a) The trustee has a duty to administer a trust according to its terms.

(b) Unless the terms of the trust provide otherwise, the trustee also has a duty:

- (1) to administer the trust solely in the interest of the beneficiaries;
- (2) to treat multiple beneficiaries impartially;
- (3) to take possession of and maintain control over the trust property;
- (4) to preserve the trust property;
- (5) to make the trust property productive;

the guardianship property;<sup>237</sup> the duty to conserve the guardianship property in excess of the protected person's current needs;<sup>238</sup> the duty to encourage the protected person's self-reliability and independence; and to consider recommendations relating to the appropriate standard of support, care, education and training for the protected person or the protected person's dependent made by the protected person's parent or guardian.<sup>239</sup> In addition, a guardian of a minor has all of the responsibilities of a parent regarding the minor's custody and support, while the guardian of a disabled person is responsible for the disabled person's care and custody.<sup>240</sup> In addition, the guardian has the following duties, without limitation:<sup>241</sup> (1) the guardian must be or shall become sufficiently acquainted with the protected person and maintain sufficient contacts with the protected person to know of the protected person's capabilities,

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- (6) to keep the trust property separate from his individual property and separate from or clearly identifiable from property subject to another trust;
  - (7) to maintain clear and accurate accounts with respect to the trust estate;
  - (8) upon reasonable request, to give the beneficiary complete and accurate information concerning any matter related to the administration of the trust and permit the beneficiary or his agent to inspect the trust property, the trustee's accounts, and any other documents concerning the administration of the trust;
  - (9) to take whatever action is reasonable to realize on claims constituting part of the trust property;
  - (10) to defend actions involving the trust estate;
  - (11) not to delegate to another person the authority to perform acts which the trustee can reasonably perform personally; and
  - (12) to supervise any person to whom authority has been delegated.

The apparent genesis of IND. CODE § 29-3-8-3(1) (1988) seems to be the UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 2-316, 8A U.L.A. 502 (1983) which provides that a conservator must act as a fiduciary and observe the standards of care applicable to trustees.

237. IND. CODE § 29-3-8-3 (1988) provides that the duty to preserve guardianship property is a mandatory duty of a guardian. Yet, IND. CODE § 29-3-8-1 (1988) provides that a guardian of a minor has this duty unless otherwise ordered by the court and that a guardian of a disabled person has this duty to the extent ordered by the court. This inconsistency in a guardian's duty to preserve can only lead to confusion, especially since one of the standards of care of a trustee which is also imposed upon a guardian is the duty to preserve the trust property. *See id.* § 30-4-3-6(a)(4).

238. This provision is contained in IND. CODE §§ 29-3-8-1(a)(3), (b)(1) & -3(3) (1988).

239. *Id.* § 29-3-8-3. *See Wishard, supra* note 91, at II-12. The author states that the phrase "or guardian" at the end of this section is either an oversight or redundancy that should be corrected.

240. IND. CODE § 29-3-8-1 (1988).

241. One wonders if the phrase "without limitation" is meaningful since IND. CODE § 29-3-8-8 (1988) provides that a court may limit the responsibilities of a guardian and create a limited guardianship.



disabilities, limitations, needs, opportunities, and physical and mental health; (2) upon termination, the guardian must comply with the appropriate NGC provisions concerning termination;<sup>242</sup> (3) the guardian must report the physical and mental condition of the protected person to the court as ordered by the court; and (4) the guardian has any other responsibilities that the court may order.<sup>243</sup>

The NGC's duties of a guardian of a minor or disabled person are extremely similar to the duties of a guardian contained in the Uniform Act.<sup>244</sup> For those guardians under prior Indiana law who were guardians of the estate (*e.g.*, a bank or trust company), the NGC duties relating to becoming acquainted with and maintaining contacts with the protected person and making reports concerning the physical and mental condition of the protected person to the court are probably ominous. In this context, these duties, which presumably were borrowed from the Uniform Act's duties of a guardian, have no logical relationship to such guardianships which more closely resemble conservatorship under the Uniform Act. Under the Uniform Act, the relationship established to protect the person of a disabled person is a guardianship<sup>245</sup> and the relationship established to protect the property of a disabled person is a conservatorship.<sup>246</sup> Each relationship has separate duties and powers.<sup>247</sup> Because of these separate duties, guardianships under the Uniform Act are not likely to be attractive positions for banks or trust companies who are more interested in handling the disabled person's estate than in his or her personal well being.<sup>248</sup> Likewise, because the NGC imposes the Uniform Act's duties of a guardian, guardianships under the NGC are not likely to be attractive to banks or trust companies. In these situations, the bank or trust company is well advised to create a limited guardianship in which its duties are limited to the management, protection, preservation and conservation of the guardianship property.<sup>249</sup> Presumably, these duties would be similar to the duties of guardians of the estate under prior Indiana law,<sup>250</sup> the duties of a conservator under the Uniform Act,<sup>251</sup>

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242. *See id.* § 29-3-12-1 to -5.

243. *Id.* § 29-3-8-1.

244. *See* UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 2-109, 8A U.L.A. 467-69 (1983); *id.* § 2-209, 8A U.L.A. 485.

245. *See id.* § 1-201(6), 8A U.L.A. 447.

246. *Id.* § 1-201(3), 8A U.L.A. 447.

247. *See id.* §§ 2-109, 2-209, 2-316, 8A U.L.A. 467-69, 485 & 502.

248. *Id.* § 2-107 comment, 8A U.L.A. 466.

249. IND. CODE § 29-3-8-8 (1988).

250. *See id.* § 29-1-18-28(b) (repealed effective July 1, 1989).

251. *See* UNIF. GUARDIAN AND PROTECTION PROCEEDINGS ACT § 2-316, 8A U.L.A. 502 (1983).

or the duties of a trustee under the Indiana Trust Code.<sup>252</sup> Yet, as previously mentioned, the NGC provides nominal guidance concerning the establishment of limited guardianships,<sup>253</sup> and, as such, practitioners are free to formulate the provisions of the limited guardianships provided that they obtain court approval. This lack of guidance from the NGC could easily result in a reduction of the duties of guardians, who under prior Indiana law were guardians of the estate, because such guardians are free to tailor the terms of limited guardianships. It is not unexpected that such discretion may be used by guardians to reduce their duties.

The NGC provides that the guardian has all of the powers necessary to perform his responsibilities.<sup>254</sup> In addition to this broad grant of power, the NGC provides a non-exhaustive list of specific powers.<sup>255</sup> While most of these enumerated powers stem from the Uniform Act or prior Indiana law,<sup>256</sup> some provisions are noteworthy. The NGC provides that the guardian has "[t]he power to purchase a home for the minor or the minor's dependents."<sup>257</sup> More importantly, the NGC provides that the guardian has the authority "to delegate to the protected person certain responsibilities for decisions affecting the protected person's business affairs and well-being."<sup>258</sup> The NGC provides that any transaction concerning guardianship property is void if there is a substantial conflict of interest between the protected person's interest and the guardian's personal interest.<sup>259</sup>

Within ninety days after appointment, a guardian must file a complete inventory of the guardianship property together with an oath or affirmation that the inventory is believed to be complete and accurate, while a temporary guardian has thirty days to do the same.<sup>260</sup> Unless otherwise directed by the court, a guardian must file a verified written account of the guardian's administration at least biennially and not more than thirty days after the anniversary date of the guardian's appointment.<sup>261</sup>

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252. See *supra* note 236 and accompanying text.

253. See *supra* note 120 and accompanying text.

254. See IND. CODE § 29-3-8-2 (1988); *id.* § 29-3-8-4.

255. See *id.*

256. See UNIF. GUARDIANSHIP AND PROTECTIVE PROCEEDINGS ACT § 2-109, 8A U.L.A. 467 (1983); IND. CODE § 29-1-18-31 to -43 (repealed effective July 1, 1989).

257. IND. CODE § 29-3-8-2(a)(7) (1988); see also Wishard, *supra* note 91, at II-11 to II-12 which states that this change from prior law is believed to have limited applicability.

258. IND. CODE § 29-3-4(2) (1988).

259. IND. CODE § 29-3-8-5 (1988) specifically provides that any sale or encumbrance of guardianship property "to a guardian or guardian's spouse, agent, attorney, or any corporation, trust, or other organization in which the guardian has a substantial beneficial interest" is a conflict of interest and void.

260. *Id.* § 29-3-9-5.

261. *Id.* § 29-3-9-6(a).



The accounting must contain "a description of the condition and circumstances of the protected person."<sup>262</sup> The NGC provides for notice of the hearing of each account,<sup>263</sup> which, if given, enables the court order approving the account to be binding on all persons.<sup>264</sup> In addition, the NGC provides for *ex parte* approval of the account, other than a final account, which may be subsequently reviewed by the court.<sup>265</sup>

### *E. Removal of a Guardian*

The NGC<sup>266</sup> retains the provisions in prior Indiana law<sup>267</sup> concerning the removal of a guardian by adopting the grounds for removal contained in the Indiana Probate Code, which provides that a court may remove a personal representative if he "becomes mentally incompetent, disqualified, unsuitable or incapable of discharging his duties, has mismanaged the estate, failed to perform any duty imposed by law or by any lawful order of the court, or has ceased to be domiciled in Indiana."<sup>268</sup> A personal representative under the Indiana Probate Code and, hence, a guardian under the NGC becomes disqualified if he is: under eighteen years old; not competent; a convicted felon; or a resident corporation not qualified to act as a fiduciary in Indiana.<sup>269</sup> "Unsuitability does not require actual misconduct or breach of duty, but includes incapacity, unwillingness, or inability to discharge the duties in the particular case with fidelity and efficiency."<sup>270</sup> In addition, "if there is such animosity . . . [as] to interfere with the . . . conduct of the guardianship, the guardian may be removed as unsuitable."<sup>271</sup> Mismanagement includes failure to manage with the "scrupulous integrity" required of a fiduciary,<sup>272</sup> failure to make the property productive,<sup>273</sup> failure to care for the property,<sup>274</sup> and commingling of the property with the fiduciary's

262. *Id.* § 29-3-9-6(c).

263. *Id.* § 29-3-9-6(d).

264. *Id.* § 29-3-9-6(f).

265. *Id.* § 29-3-9-6(e).

266. *Id.* § 29-3-12-4.

267. *See id.* § 29-1-18-25 (repealed effective July 1, 1989).

268. *Id.* § 29-1-10-6 (1988).

269. *See supra* note 200 and text accompanying notes 200-06.

270. Falender, *Removal, Termination and Foreign Guardians*, ICLEF GUARDIANSHIP SEMINAR VII-13 (1988) (citing *In re Estate of Baird*, 408 N.E.2d 1323, 1327 (Ind. Ct. App. 1980) (quoting *Grossman v. Grossman*, 343 Mass. 565, 179 N.E.2d 900 (1962))).

271. Falender, *supra* note 270, at VII-13 (citing *Estate of Jaworski v. Jaworski*, 479 N.E.2d 89 (Ind. Ct. App. 1985)).

272. *E.g.*, *Helm v. Odle*, 129 Ind. App. 478, 157 N.E.2d 584 (1959) *cited in* Falender, *supra* note 270, at VII-26.

273. *E.g.*, *Brannock v. Stocker*, 79 Ind. 558 (1881), *cited in* Falender, *supra* note 270, at VII-26.

274. *Id.*

personal assets.<sup>275</sup> Failure to comply with the law or a lawful order of court includes failure to file an inventory,<sup>276</sup> a bond<sup>277</sup> or an accounting<sup>278</sup> as required by the NGC or court order. Finally, the Indiana Probate Code's removal provision concerning ceasing to be domiciled in Indiana arguably should not apply to the NGC.<sup>279</sup>

The manner for removal contained in the Indiana Probate Code<sup>280</sup> is incorporated by reference in the NGC.<sup>281</sup> These removal procedures provide that a court either on its own motion, or on petition of any person interested in the guardianship, shall order the guardian to appear and show cause why he should not be removed.<sup>282</sup> This procedure includes notice and hearing provisions.<sup>283</sup> In addition, a court may remove a guardian under an *ex parte* emergency procedure.<sup>284</sup> Arguably, the terms of NGC might prohibit a court from removing a guardian on its own motion.<sup>285</sup>

Upon removal, the authority and responsibility of a guardian terminates.<sup>286</sup> While the removal of a guardian does not invalidate the guardian's acts or omissions prior to removal,<sup>287</sup> it also does not affect the guardian's liability for such acts or the obligation to account for the guardian's conduct of the guardian's trust.<sup>288</sup> Upon the removal of a guardian, the guardian must give a final accounting to the court.<sup>289</sup> Finally, upon finding that a guardian is not effectively performing his fiduciary duties and that the welfare of the protected person requires immediate action, a court may appoint a replacement temporary guardian.<sup>290</sup>

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275. *E.g.*, *In re Guardianship of Brown*, 436 N.E.2d 877, 888 (Ind. Ct. App. 1982); *Rigby v. Leister*, 147 Ind. App. 438, 261 N.E.2d 891 (1970) *cited in* Falender, *supra* note 270, at VII-26, VII-27.

276. *E.g.*, *Rigby v. Leister*, 147 Ind. App. 438, 261 N.E.2d 891 (1970) *cited in* Falender, *supra* note 270, at VII-27.

277. *See, e.g.*, *Toledo, St. Louis & Kansas City R.R. v. Reeves*, 8 Ind. App. 667, 35 N.E. 199 (1894) *cited in* Falender, *supra* note 270, at VII-27.

278. *E.g.*, *Rigby v. Leister*, 147 Ind. App. 438, 261 N.E.2d 891 (1970) *cited in* Falender, *supra* note 270, at VII-28.

279. *See* Falender, *supra* note 270, at VII-13 to VII-14.

280. IND. CODE § 29-1-10-6 (1988).

281. *Id.* § 29-3-12-4(a).

282. *Id.* § 29-1-10-6(a).

283. *Id.*

284. *Id.* § 29-1-10-6(b).

285. *See* Falender, *supra* note 270, at VII-15. The NGC specifically states that a court may remove a guardian "on petition" which could be construed to prohibit a court from removing a guardian on its own motion. IND. CODE § 29-3-12-4(a) (1988).

286. IND. CODE § 29-3-12-5 (1988).

287. *Id.* § 29-3-12-4(c).

288. *Id.* § 29-3-12-5.

289. *Id.* § 29-3-12-4(a); *see also supra* notes 261-65 and accompanying text.

290. *See supra* notes 92-93 and accompanying text.



### F. Termination of a Guardianship

The NGC's grounds for termination<sup>291</sup> are substantially the same as prior Indiana law.<sup>292</sup> Unless a minor is adjudicated a disabled person, the guardianship of a minor must terminate upon the minor's attaining eighteen years of age or the minor's death and may terminate upon the adoption or marriage of the minor.<sup>293</sup> Furthermore, the guardianship of a disabled person must terminate upon the court's determination that the protected person is no longer disabled or upon the protected person's death.<sup>294</sup> The court also has broad discretion to terminate the guardianship for other reasons.<sup>295</sup>

The protected person or any other person may petition for an order terminating the guardianship or a protective order.<sup>296</sup> "A request for an order may also be made informally to the court."<sup>297</sup> Presumably, the NGC's general notice and hearing requirements apply to any petition or request for termination.<sup>298</sup> This right to petition may be limited by the court's authority to specify in a prior order a minimum period, not exceeding one year, during which a petition for termination may not be filed.<sup>299</sup>

Upon termination, the guardian has no more than thirty days to file a written verified account of the guardian's administration.<sup>300</sup> The authority and responsibility of a guardian terminates upon the termination of the guardianship,<sup>301</sup> with the exception of certain ministerial functions.<sup>302</sup>

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291. See IND. CODE § 29-3-12-1 (1988).

292. See *id.* § 29-1-18-47 (repealed effective July 1, 1989).

293. *Id.* § 29-3-12-1(a) (1988).

294. *Id.* § 29-3-12-1(b).

295. IND. CODE § 29-3-12-1(c) (1988) provides:

(c) The court may terminate any guardianship if:

- (1) the guardianship property does not exceed the value of three thousand five hundred dollars (\$3,500);
- (2) the guardianship property is reduced to three thousand five hundred dollars (\$3,500);
- (3) the domicile or physical presence of the protected person is changed to another state and a guardian has been appointed for the protected person and the protected person's property in that state; or
- (4) the guardianship is no longer necessary for any other reason.

296. *Id.* § 29-3-12-3.

297. *Id.*

298. See *supra* notes 172-89 and accompanying text.

299. IND. CODE § 29-3-12-3 (1988).

300. *Id.* § 29-3-9-6(a)(2); see also *supra* notes 261-65 and accompanying text.

301. IND. CODE § 29-3-12-5 (1988).

302. IND. CODE § 29-3-12-1(d) (1988) provides that if the guardianship terminates for any reason other than death, the guardian "may pay the claims and expenses of

### G. *Foreign Guardianships*

The NGC<sup>303</sup> has expanded the substantive provisions contained in prior Indiana law<sup>304</sup> concerning foreign guardianships. The NGC allows a foreign guardian to collect debts and assets in Indiana upon proof of his appointment and the presentation of an affidavit containing specified information.<sup>305</sup> “If the person to whom the affidavit is presented does not know of any other guardianship proceeding pending in Indiana,” payment or delivery may be made in response to the affidavit without further liability.<sup>306</sup> A foreign guardian may exercise all powers of a guardian with respect to property of a disabled person or minor located in Indiana and to maintain actions and proceedings in Indiana if certain requirements have been met.<sup>307</sup> Finally, upon collecting debts and assets or exercising any power of a guardian with respect to property located in Indiana, the foreign guardian submits personally to the jurisdiction of Indiana courts in a proceeding relating to such property.<sup>308</sup>

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administration that are approved by the court and exercise other powers that are necessary to complete the performance of the guardian’s trust, including payment and delivery of the remaining property for which the guardian is responsible to the protected person. In addition, IND. CODE § 29-3-12-1(e) provides that if the guardianship terminates because of the protected person’s death, the guardian

may pay the expenses of administration that are approved by the court and exercise other powers that are necessary to complete the performance of the guardian’s trust and may deliver the remaining property for which the guardian is responsible to the protected person’s personal representative. If approved by the court, the guardian may pay directly the following:

- (1) Reasonable funeral and burial expenses of the protected person.
- (2) Reasonable expenses of the protected person’s last illness.
- (3) The protected person’s federal and state taxes.
- (4) Any statutory allowances payable to the protected person’s surviving spouse or surviving children.
- (5) Any other obligations of the protected person.

303. *Id.* § 29-3-13-1 to -3.

304. *Id.* § 29-1-18-52 (repealed effective July 1, 1989).

305. *Id.* § 29-3-13-1(a) (1988). The affidavit must state:

- (1) That the foreign guardian does not know of any other guardianship proceeding, relating to the disabled person or minor, pending in Indiana.
- (2) That the letters of the foreign guardian were duly issued.
- (3) That the foreign guardian is entitled to receive the payment or delivery.

306. *Id.* § 29-3-13-1(b).

307. *Id.* § 29-3-13-2. These requirements are: (a) that no guardian has been appointed, and no petition in a guardianship proceeding is pending in Indiana; (b) that the guardian has been appointed by a court in the state of the disabled person’s or minor’s domicile; and (c) that the guardian files an authenticated copy of the guardian’s appointment and a bond in the court in the county in which the disabled person’s or minor’s property is located.

308. *Id.* § 29-3-13-3.





# Survey of Indiana Property Law

WALTER W. KRIEGER\*

## I. BROKERS

*Craig v. ERA Mark Five Realtors*<sup>1</sup> involves the liability of a real estate broker for listing property as a "multi-family" apartment building when such use was in violation of the applicable zoning ordinance. The seller listed a two-story structure, which had been converted into a multi-family dwelling, with ERA Mark Five Realtors (ERA). ERA showed the property to Hugh Craig, who agreed to purchase the property subject to an existing land contract containing a balloon payment clause.<sup>2</sup> No one at ERA was aware of the specific zoning of the property at the time of the closing. More than two years after the closing, the City of Indianapolis informed Craig that the use of the property as a multi-family dwelling violated the local zoning ordinance. Craig filed suit against ERA.<sup>3</sup>

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\* Associate Professor of Law, Indiana University School of Law—Indianapolis. A.B., Bellarmine College, 1959; J.D., University of Louisville, 1962; L.L.M., George Washington University, 1969. The author wishes to express his appreciation to Thomas A. Brodnik for his assistance in the preparation of this Article.

1. 509 N.E.2d 1144 (Ind. Ct. App. 1987).

2. *Id.* at 1145. The purchaser also alleged that ERA had misrepresented the terms of the installment land contract. The evidence indicated, however, that the seller had failed to mention the balloon payment clause to ERA at the time he listed the property and that when ERA discovered the terms of the contract, shortly before the closing, it immediately informed Craig of the balloon payment clause and offered to rescind the contract. Because Craig was given the opportunity to back out of the deal and chose instead to go ahead with the closing, the court concluded that one of the essential elements of fraud, detrimental reliance, was missing. *Id.* at 1145-47.

3. *Id.* at 1146. Craig did not sue the seller nor did he attempt to rescind the original land contract which contained a representation that there were no existing zoning violations. A zoning ordinance does not affect the marketability of title and buyer takes subject to zoning regulations. However, existing violations of zoning ordinances are often held to make title unmarketable and would allow rescission of the contract for sale. H. CUNNINGHAM, W. STOEBUCK & D. WHITMAN, *THE LAW OF PROPERTY* § 10.12, at 694 (1984) [hereinafter CUNNINGHAM]; Dunham, *Effect on Title of Violations of Building Covenants and Zoning Ordinances*, 27 ROCKY MTN. L. REV. 255 (1955); Freyfogle, *Real Estate Sales and the New Implied Warranty of Lawful Use*, 71 CORNELL L. REV. 1 (1985). Where the sale has been completed and the contract has merged into the deed, courts occasionally have found the existing breach of a zoning ordinance to be an encumbrance under the covenants of title. Freyfogle, *supra*, at 4 n.11; Dunham, *supra*, at 258 n.9.



Craig alleged that ERA committed actual fraud by misrepresenting the zoning status of the property. ERA made no representation concerning the specific zoning classification of the property, but the listing agreement and the multiple-listing worksheet described the property as "multi-family."<sup>4</sup> The court, however, reasoned that: "The mere fact that the defendants represented the property as an apartment building does not rise to the level of an affirmative representation that the use of the property was permissible under the applicable zoning ordinance."<sup>5</sup>

Craig also argued that ERA had agreed to act as his agent in the transaction, and that as such it was under a duty to check the zoning status of the property. The court, however, concluded that assuming *arguendo* a fiduciary relationship existed, ERA had no duty to determine the zoning status of the property. Where information regarding zoning is readily available and easily accessible to all the parties in the public records, the purchaser can not attack the validity of the contract for fraud, misrepresentation or concealment of the problem.<sup>6</sup> The court noted that Craig and his wife were not inexperienced amateurs in the real estate business. Both Craigs have been licensed to sell real estate in Indiana since the mid-1970's. Prior to this transaction the Craigs owned a duplex and a commercial building which Mr. Craig managed. In addition, Mr. Craig is or was president of Adobe Realty, and at one time owned and operated a real estate school. Thus, the court found that "although the Craigs were not represented by an attorney at the closing, they certainly possessed the skill and knowledge about ascertaining the property's zoning."<sup>7</sup>

## II. CONCURRENT OWNERSHIP: TENANCY BY THE ENTIRETY

At common law any conveyance of real property to a husband and wife was deemed to create a tenancy by the entirety because of the unity of marriage.<sup>8</sup> Marriage was said to create a "oneness" in the husband and wife so that neither had an individual interest in the property apart from the single entity. They held title *per tout et non*

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4. *Craig*, 509 N.E.2d at 1147.

5. *Id.*

6. *Id.* at 1148 (citing *Winstead v. First National Bank N.A.*, 709 S.W.2d 627, 631 (Tenn. App. 1986)).

7. *Id.* The court also determined that the two year statute of limitations, Ind. Code § 34-1-2-2(1) (1988), applied to the count alleging negligence on the part of ERA in not discovering the zoning problem, that damages accrued on the date of closing, and that the trial court was not in error in granting a partial summary judgment. *Id.* at 1149-50.

8. *Cunningham*, *supra* note 3, § 5.5, at 210-11.

*per my* (by the whole but not by the part).<sup>9</sup> One of the most important attributes of this type of co-ownership was the right of survivorship and, since neither spouse alone had a separate interest which could be conveyed to a third person, this right of survivorship was indestructible without the consent of both spouses.<sup>10</sup> Likewise, since neither spouse had a separate interest apart from the whole, it was held that a creditor of only one spouse could not reach tenancy by the entirety property to satisfy the claim against the debtor-spouse.<sup>11</sup> After the enactment of the Married Woman's Property Act,<sup>12</sup> which removed the disabilities of married women, many states abolished tenancy by the entirety.<sup>13</sup> While this type of co-ownership has been abolished in over half the states, a substantial minority of states, including Indiana, still allow this form of co-tenancy between husband and wife.<sup>14</sup> At common law the personal property of a married woman was owned by the husband<sup>15</sup> and, as a result, tenancy by the entirety was not applied to personalty.<sup>16</sup> However, after enactment of the Married Woman's Property Act, those states which still recognized tenancy by the entirety had to decide whether or not to permit this type of co-ownership in personal property. A number of these states, including Indiana, chose not to apply it in

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9. *Id.*; C. MOYNIHAN, INTRODUCTION TO THE LAW OF REAL PROPERTY 218-19 (2d ed. 1988).

10. C. MOYNIHAN, *supra* note 9, at 219.

11. At common law the husband's creditors appear to have had a right to attach the entirety property for and during the husband's life because of his right to exercise control over the land. However, this position is in conflict with the Married Women's Property Act and the modern view of the husband and wife relationship. *See* Chandler v. Cheney, 37 Ind. 391, 404-14 (1871); Davis v. Clark, 26 Ind. 424, 428-29 (1866). In a substantial majority of the states still recognizing tenancy by the entirety, creditors of only one spouse cannot attach entirety property. Phipps, *Tenancy by Entireties*, 25 Temple L. Q. 24 (1951). Indiana follows the rule that the creditor of only one spouse cannot attach entirety property. *E.g.*, Mercer v. Coomler, 32 Ind. App. 533, 69 N.E. 202 (1903); Patton v. Rankin, 68 Ind. 245 (1879).

12. In the 19th century most states enacted what is commonly known as Married Women's Property Acts, which removed the common law disabilities of married women to own property. *See* Ind. Code § 31-1-9-2 (1988). For a brief history and discussion of the *feme sole* acts in Indiana, see 2A G. HENRY, HENRY'S PROBATE LAW AND PRACTICE OF THE STATE OF INDIANA, Ch. 27, § 2, at 299-319 (J. Grimes 7th ed. 1979) [hereinafter HENRY'S].

13. C. MOYNIHAN, *supra* note 9, at 220.

14. For a list of states still recognizing the tenancy by the entirety see Cunningham, *supra* note 3, § 5.5, at 211 n.3. For a brief history and discussion of the Indiana law of tenancy by the entirety see HENRY'S, *supra* note 12, ch. 34, § 3, at 339-73.

15. HENRY'S, *supra* note 12, ch. 27, § 2, at 299.

16. CUNNINGHAM, *supra* note 3, § 5.5, at 215; HENRY'S, *supra* note 12, ch. 34, § 3, at 351-52.



general to ownership of personal property.<sup>17</sup> The Indiana law governing the tenancy by the entirety is discussed in the three cases under review.

### A. *Proceeds from Sale of Crops*

As a general rule, Indiana does not recognize tenancy by the entirety in personal property,<sup>18</sup> but Indiana has made an exception with regard to the proceeds from the sale of land held by the entirety,<sup>19</sup> and with regard to crops grown on tenancy by the entirety property.<sup>20</sup> In a case of first impression, *Schoon v. Van Diest Supply Co.*,<sup>21</sup> the Indiana Court of Appeals held that the proceeds from the sale of crops grown on tenancy by the entirety property can be attached by the creditor of one of the spouses. While the court recognized that personal property "derived *directly* from real estate held by the entirety, such as crops on the land or proceeds arising from the sale of land held by the entirety" can not be attached by such creditors, the court determined that the proceeds from the sale of crops amounted to "proceeds from proceeds" and that the trial court was correct in not enlarging the law authorizing estates by entirety to include such proceeds.<sup>22</sup>

### B. *Bankruptcy: Release of Interest in Entirety Property by Debtor-Spouse*

In *In re Agnew*,<sup>23</sup> the United States Court of Appeals for the Seventh Circuit concluded that under Indiana law the release of an interest in the proceeds from the sale of tenancy by the entirety property by one spouse to the other was not a transfer of property and that no "division" of proceeds occurred. In *Agnew* the husband filed for

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17. C. MOYNIHAN, *supra* note 9, at 220 n.1; HENRY's, *supra* note 12, ch. 34, § 3, at 351-52.

18. *E.g.*, *Koehring v. Bowman*, 194 Ind. 433, 142 N.E. 117 (1924); *Abshire v. State*, 53 Ind. 64 (1876); *Schoon v. Van Diest Supply Co.*, 511 N.E.2d 12 (Ind. Ct. App. 1987).

19. *E.g.*, *Whitlock v. Public Service Co.*, 239 Ind. 680, 159 N.E.2d 280, *reh'g denied*, 239 Ind. 694, 161 N.E.2d 169 (1959); *Abshire v. State, ex rel. Wilson*, 53 Ind. 64 (1876); *Anuszkiewicz v. Anuszkiewicz*, 172 Ind. App. 279, 360 N.E.2d 230, 232 (1977).

20. *E.g.*, *Koehring v. Bowman*, 194 Ind. 433, 142 N.E. 117 (1924); *Patton v. Rankin*, 68 Ind. 245 (1879); *Mercer v. Coomler*, 32 Ind. App. 533, 69 N.E. 202 (1903).

21. 511 N.E.2d 12 (Ind. Ct. App. 1987).

22. *Id.* at 13-14 (emphasis in original). The court relied heavily on the language of *Koehring v. Bowman*, 194 Ind. 433, 142 N.E. 117 (1923), that tenancies by the entirety "are not in harmony with any other part of the law of Indiana governing the legal rights of husband and wife and the law authorizing their creation *will not be enlarged by construction.*" *Koehring*, 194 Ind. at 437, 142 N.E. at 118 (emphasis added).

23. 818 F.2d 1284 (7th Cir. 1987).

Chapter 7 bankruptcy because of certain business debts incurred as part owner of a plumbing business. Lee Supply Corporation, a creditor, objected to the discharge of the husband's debts because the husband had released to his wife his interest in the proceeds from the sale of property owned by them as tenants by the entirety. The wife subsequently used the funds from the sale to build another house on land which she individually owned. The release of the husband's interest occurred within one year of the date the husband filed his petition in bankruptcy and the creditor's complaint objecting to the discharge alleged "defendant with the intent to hinder, delay or defraud a creditor of the estate transferred property of the debtor to another [in violation of 11 U.S.C. 727(a)(2)]."<sup>24</sup> The bankruptcy judge and the district court both found in favor of the debtor and the creditor appealed.

On appeal, the creditor argued that the release of his interest by the husband caused a momentary division of the proceeds which caused the interest to lose its exempt status and made it subject to his individual debts.<sup>25</sup> While the court could find no Indiana case directly on point, it noted with interest the language in *Enyeart v. Kepler*<sup>26</sup> where the husband, after his wife's death, claimed his earlier deed transferring his interest to his wife was void because entirety property can only be conveyed by both parties. In sustaining a demurrer to the husband's claim by the devisees of the property under the wife's will, the court held that the conveyance by the husband to his wife operated as "a relinquishment of the husband's right as survivor."<sup>27</sup> From this language the court concluded that under Indiana law Agnew did nothing more than relinquish his survivorship right to the proceeds from the sale

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24. *Id.* at 1286. The bankruptcy judge appears to have based his decision more on the failure to prove fraudulent intent rather than the question of whether the release was a transfer of property. The bankruptcy judge found that there were several valid reasons why the husband released his interest in the proceeds of the sale to his wife. First, a second mortgage on the house had been taken out to finance the start up of the husband's failed business venture, and the repayment of the mortgage out of the proceeds could be viewed as a repayment of a debt of the husband. Second, after the business failed, the wife began making monthly payments to Lee Supply Corporation on the husband's business debts from her own funds. Finally, the facts established that the wife had contributed most of the funds for the purchase of the house. *Id.* at 1285-86. Thus, the husband may have felt morally obligated to release his interest in the proceeds from the sale to his wife. The bankruptcy judge found that the creditor had failed to prove that the husband had made a transfer of assets with the intent to defraud his creditors, that he had concealed information or that he had made a false oath or account. *Id.* at 1286.

25. *Id.* at 1288.

26. 118 Ind. 34, 20 N.E. 539 (1889).

27. *Id.* at 38, 20 N.E. at 541.



and that no separate interest ever vested in the husband which could be reached by his creditor.<sup>28</sup>

The decision seems to be in accord with the common law concept that neither spouse really has an interest apart from the oneness of husband and wife. Thus, a "release" by one of the parties would simply leave the entire interest in the remaining tenant and nothing would pass from one party to the other.<sup>29</sup>

### C. Contract For Sale by One Spouse: Enforceability

In *Lafray v. Lafray*,<sup>30</sup> a son entered into an oral contract with his father agreeing to perform services in exchange for his father's promise to convey the family farm to him at the death of the surviving tenant by the entirety. After the father's death, the mother brought this action to evict the son and his wife. The trial court ordered their eviction and the son appealed.<sup>31</sup> On appeal, the son argued that the court had improperly excluded evidence of the oral contract. The court, however, concluded that the real issue was not whether the contract with his father existed, but rather whether the mother would be bound by the contract.<sup>32</sup> The court found the agreement void because the husband had no separate interest in the farm which he could contract away.<sup>33</sup> There was no evidence that the mother had authorized the contract or that she had ratified the agreement by accepting the services with knowledge of the agreement.<sup>34</sup> Alternatively, the son sought to recover in *quantum meruit* for the value of improvements made and services performed, but the court found that the son, who had resided rent and tax free on the land for ten years, had acted on his own rather than his mother's behalf in making the improvements and performing the services.<sup>35</sup> The court also concluded that the son was a tenant at

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28. *Agnew*, 818 F.2d at 1289.

29. By analogy, Indiana has consistently held that at the death of one of the spouses the interest of the deceased spouse disappears and no interest passes from the deceased spouse to the survivor. *E.g.*, *Anuszkiewicz v. Anuszkiewicz*, 172 Ind. App. 279, 360 N.E.2d 230 (1977); *Department of Revenue v. Weinstein*, 141 Ind. App. 395, 228 N.E.2d 23, *reh'g denied*, 141 Ind. App. 399, 229 N.E.2d 741 (1967); *Vonville v. Dexter*, 118 Ind. App. 187, 76 N.E.2d 856 (1948).

30. 522 N.E.2d 916 (Ind. Ct. App. 1988).

31. *Id.* at 917.

32. *Id.*

33. *Id.* at 918.

34. *Id.* The mother testified that her son had moved onto the farm for personal reasons and that she did not know that he was performing these services as consideration for the alleged contract. *Id.*

35. *Id.* at 919.

sufferance, and that a tenant may not charge his landlord for improvements to the property absent an express contract.<sup>36</sup>

### III. COVENANTS

In *Rasp v. Hidden Valley Lake, Inc.*,<sup>37</sup> the developer of Hidden Valley Lake subdivision, Hidden Valley Lake, Inc. (HVL Developer), spread of record and placed in the deeds to the subdivision lots a covenant providing for the payment of a \$5.00 a month water and \$3.00 a month sewer "availability" fee, payable annually and in advance, by lot owners choosing not to connect to the water and sewer lines adjacent to their lots.<sup>38</sup> HVL Developer then transferred the sewer and water lines to HVL Services, Inc. and HVL Utilities, Inc., two wholly-owned public utilities subject to regulation by the Public Service Commission of Indiana. Both utilities operated at a loss but HVL Developer paid any deficits out of the "availability" fee fund. Defendants (Rasps) were not hooked up to the utilities and had refused to pay the availability fees. HVL Developer filed suit to recover delinquent availability fees, late charges, interest and attorney fees. The Rasps appealed from a judgment in favor of HVL Developer. Three issues were raised: (1) whether the fees were void as against public policy; (2) whether the covenant ran with the land and bound subsequent purchasers of the lots; and (3) whether the fees should be paid to HVL Developer or to the two public utility corporations as the assignees of the sewer and water lines.<sup>39</sup>

With regard to the first issue, Rasps claimed that the covenant was unconscionable because it forced them to subsidize public utility companies from whom they received no benefit and was a windfall to HVL Developer who could then expend the funds to promote further sales of its lots. The court disagreed finding that this "mildly coercive incentive" to connect to existing sewer and water is in the public interest as it will promote a more healthful environment in the subdivision and broaden the rate base and reduce the rates charged for the utility services.<sup>40</sup> The court eliminated the second part of the Rasps first argument by finding that the installation of water and sewer lines by a private developer impresses that portion of the business with a "public interest" which would prevent him from profiting from the providing of such services.<sup>41</sup> Once the developer has recovered the costs

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36. *Id.*

37. 519 N.E.2d 153 (Ind. Ct. App. 1988).

38. *Id.* at 155.

39. *Id.* at 154.

40. *Id.* at 156.

41. *Id.* at 156-57.



of installation and a reasonable profit for his efforts, he became a trustee of the funds received from that portion of the business and had to account for their use.<sup>42</sup>

Rasps next argued that the covenant was a personal covenant between HVL Developer and the original lot owners which did not run with the land and bind subsequent purchasers who were not parties to the agreement. The court disagreed pointing out that "the purpose of the restrictive covenant was to assure that sewer and water services would be available to all the lots in the subdivision."<sup>43</sup> A covenant is capable of running with the land: (1) when the grantor intends it to run; (2) when there is "privity of estate between the subsequent grantees of the original covenantor and covenantee[; and (3)] when the covenant touches and concerns the land."<sup>44</sup> Without further discussion, the court concluded that "[t]he covenant here at issue meets all these requirements."<sup>45</sup>

On the final issue, however, the court did agree with the Rasps that they should not be forced to pay the fee to HVL Developer once the sewer and water lines had been transferred to the utility corporations. In the court's opinion, the wording of the covenant indicates that an assignment was contemplated by the parties from the use of the phrase "grantor, its successors or assigns." An assignment transfers to the assignee all the rights, title, and interest of the assignor in the property assigned. Thus, the judgment was reversed and the case remanded to the trial court for a new trial to ascertain the date and terms of the transfer to the utility corporations in order to determine the real party in interest.<sup>46</sup>

In another case involving restrictive covenants, *Rajski v. Tezich*,<sup>47</sup> the Rajskis purchased a house in a subdivision, and began construction of a two car unattached garage. They were informed by neighbors of the potential violation of restrictive covenants, and the architectural committee of the Homeowners Association made suggestions to bring the building closer to conformity with the covenants. Despite these warnings and without the approval of the architectural committee, the Rajskis continued construction of the garage. The relevant provision

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42. *Id.*

43. *Id.* at 157.

44. *Id.*

45. *Id.* One might question whether the assignment of the water and sewer lines to the utility corporations gave them a property interest and whether the benefit touched and concerned the land. Collection of the availability fees benefits the utility corporations directly and only indirectly benefits lot owners by lowering the sewer and water rates.

46. *Id.* at 157-58.

47. 514 N.E.2d 347 (Ind. Ct. App. 1987).

of the covenant provided that unless a violation was corrected within thirty days after notice to cure or terminate was given by certified mail by any person having a right to enforce the covenants, the violator would be liable for liquidated damages in the amount of \$10 (payable to the Homeowners Association) for each day the violation continued, together with attorney fees and court costs.<sup>48</sup>

George Tezich, a homeowner in the subdivision and president of the Homeowners Association, sent the Rajskis notice by certified mail demanding the removal of the garage within thirty days and invoking the liquidated damages provision contained in the restrictive covenants. Subsequently Tezich, James Hall (another homeowner), and the Homeowners Association filed suit demanding removal of the structure, liquidated damages, and attorney fees. The trial court ordered that the garage either be attached or removed, awarded liquidated damages in the amount of \$2,930 to the date of judgment, and awarded attorney fees of \$3,750.<sup>49</sup> On appeal, the court found that the liquidated damages provision was unenforceable as a penalty.<sup>50</sup> The provision had no relation to actual damages as it provided the same sum for a violation of any of the numerous restrictions, some substantial and some trivial, that ranged from the size, design, and locations of structures down to the type of garbage cans that could be used by lot owners. In addition, the court noted that the damages were payable to the Homeowners Association and not the property owners, "at odds with the notion of providing compensation to interested parties for actual injuries."<sup>51</sup>

The Rajskis also argued that the notice of violations sent by Tezich was defective because it was sent by Tezich in his capacity as president of the Homeowners Association. Prior to trial, the lower court had ruled that the Homeowners Association lacked standing to act as a party because the covenant provided that the restrictions were enforceable only by a "property owner."<sup>52</sup> Since this ruling was not challenged, the Rajskis argued they were never notified as required by the language of the covenant. In rejecting this argument, the court noted that Tezich was in fact a lot owner entitled to bring suit and give notice. The words "President, Meadowview Third Addition Homeowners Association" following his signature on the notice were merely *descriptio personae* and did not prevent the inference that he was acting in an

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48. *Id.* at 348.

49. *Id.*

50. *Id.* at 349.

51. *Id.*

52. *Id.* at 348 n.1.



individual capacity.<sup>53</sup> The court vacated the award denominated as liquidated damages and otherwise affirmed the judgment.<sup>54</sup>

#### IV. DEEDS

##### A. *Easement vs. Fee*

In *Brown v. Penn Central Corp.*,<sup>55</sup> owners of lots contiguous to abandoned railroad right-of-way sought to quiet title to the land in themselves. The trial court found that the portion of an 1871 deed conveying a 100-foot wide right-of-way to the grantee-railroad created nothing more than an easement which was extinguished when the railroad ceased to use the property for railroad purposes and quieted title in the lot owners. However, the trial court found the portion of the deed conveying a strip of land adjacent to the right-of-way 200 feet wide and 1000 feet in length "for Depot and Rail Road purposes" conveyed fee simple title to the strip of land in the railroad company.<sup>56</sup> The court of appeals affirmed the trial court's determination and the lot owners petitioned for transfer.<sup>57</sup>

On petition to transfer, the Indiana Supreme Court set forth certain rules of construction to be used when construing the meaning of a deed: (1) The object is to determine the intent of the parties; (2) where the deed is unambiguous, the intent must be determined from the language of the deed alone; (3) where the grantee prepares the instrument of conveyance, the grantee will be construed in the light most favorable to the grantor; (4) a deed conveying a "right" usually conveys only an easement; and (5) a conveyance of a strip of land without additional language as to the use or purpose for which the land is to be used is construed as passing an estate in fee.<sup>58</sup> Examining the deed in question under these rules of construction, the court observed that the language of the deed provided that the strip of land was to be used "for Depot and Rail Road purposes," and the granting clause in the pre-printed portion of the deed expressly stated that the grantors were conveying a right of way.<sup>59</sup> The court of appeals in affirming

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53. *Id.* at 349.

54. An additional issue involving whether an award in the amount of \$3,750 in attorney fees was excessive is not discussed.

55. 510 N.E.2d 641 (Ind. 1987).

56. *Id.* at 642.

57. *Id.*

58. *Id.* at 643-44. These rules of construction are discussed and authority cited in the opinion. *Id.*

59. *Id.* at 644.

the decision of the trial court found the deed ambiguous because the portion of the deed conveying the depot property was hand-written into the pre-printed form. However, the supreme court noted that the hand-written portion was merely a description of the boundaries of the railroad right of way, which included the depot property. Furthermore, since the hand-written portion stated that the conveyance was "for Depot and Rail Road purposes," there was no need to speculate as to the intent of the parties in 1871.<sup>60</sup> The railroad company chose to use the pre-printed form and the language will be construed against it. Finally, the court noted that "[p]ublic policy does not favor the conveyance of strips of land by [fee] simple titles to railroad companies for right-of-way purposes, either by deed or condemnation."<sup>61</sup> Ownership of the land in fee is not necessary for the purpose for which the land was acquired and the severance of the strips from the parent bodies of land "operates adversely to the normal and best use of the property involved."<sup>62</sup> The court concluded that the railroad acquired only an easement to the land for depot and railroad purposes which was extinguished upon the abandonment of the right of way.

### *B. Strip of Land Excluded from Deed*

In *Maxwell v. Hahn*,<sup>63</sup> the Redmonds created two subdivisions on an 8.5-acre tract of land on Dewert Lake in Kosciusko County. They first platted and recorded "Redmond's Second Addition," consisting of thirteen lots. A strip of land between the thirteen lots and the lake was not included in the deeds to the lots. The recorded subdivision plat provided that "[t]he area between the lake and the lots is common ground for the use of the owners of these lots or future lots that may be laid out west of this addition."<sup>64</sup> Subsequently, the Redmonds platted and recorded the "Third Addition to Redmond Park," consisting of nineteen lots to the west of the Second Addition. The owners of the "Third Addition" lots claimed the right to use the common ground on the lake shore for purposes of swimming, fishing, and the erection of piers to dock their boats. The trial court recognized an easement on behalf of the owners of lots in the Third Addition to swim and fish in the lake, but held that the developers had vested fee simple title to the common area in the owners of the lots in the Second

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60. *Id.*

61. *Id.* (quoting *Ross, Inc. v. Legler*, 245 Ind. 655, 659, 199 N.E.2d 346, 347-48 (1964)).

62. 510 N.E.2d at 644.

63. 508 N.E.2d 555 (Ind. Ct. App. 1987).

64. *Id.* at 556.



Addition.<sup>65</sup> As owners of the fee, the Second Addition lot owners had exclusive riparian rights to erect piers or docks on the lake shore.<sup>66</sup>

On appeal, the Second Addition landowners cited to the court several Indiana Supreme Court decisions holding that the fee to strips of land abutting against highways and bodies of water should vest in the adjacent landowners.<sup>67</sup> The court noted, however, that where lands are granted according to a plat, the plat becomes a part of the deed with regard to the limit of the land being conveyed.<sup>68</sup> Here, the language in the plat of the Second Addition clearly indicated that the strip was common ground for the use of both the Second and Third Addition lot owners. This language rebutted the standard presumption that the fee in the strip of land abutting a body of water should be vested in the adjacent landowners.<sup>69</sup> As co-owners of an easement, all the lot owners had the right to construct, alter, or improve the easement so long as their actions do not unreasonably interfere with the rights of the other co-owners to enjoy the easement. In dictum, the court noted that the owners of the Second Addition had maintained the common area and paid the taxes on the land. They might have acquired title to the common areas by adverse possession but the point was never argued.<sup>70</sup>

### C. Delivery

In *ITT Industrial Credit Co. v. R.T.M. Development Co., Inc.*,<sup>71</sup> R.T.M. Development Co., Inc. (RTM) approached the Zimmers and offered to purchase their property for \$100,000. The Zimmers executed a warranty deed to the property to RTM but, on the advice of their attorney and a banker, they inserted the words "Not valid until receipt of full payment" across the top of the deed.<sup>72</sup> The Zimmers handed the deed to RTM's agent but advised him that the deed was not to be delivered until the purchase price was paid in full (subsequently, the agent surrendered the deed to RTM even though full payment had not been made). On November 7, 1980, RTM executed a mortgage on

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65. *Id.* at 557.

66. *Id.*

67. *Id.* at 558.

68. *Id.* (citing *Gary Land Co. v. Griesel*, 179 Ind. 204, 209, 100 N.E. 673, 675 (1913)).

69. "There was no evidence presented to the trial court to support the finding that the conveyance by the plat owners . . . included the land contiguous to Dewart Lake and the lake approaches." *Maxwell*, 508 N.E.2d at 558.

70. *Id.* at n.1.

71. 512 N.E.2d 201 (Ind. Ct. App. 1987).

72. *Id.* at 202.

the property as security for a loan obtained from ITT Industrial Credit Corp. (ITT). Sometime before the closing between the Zimmers and RTM on November 12, 1980, the words at the top of the deed were crossed out and the Zimmers initials were written nearby (subsequently, the trial court found that the Zimmers had not crossed out the words at the top of the deed or written their initials on it).<sup>73</sup> At the closing, the Zimmers received \$30,000 but claimed they were told that it was merely a down payment and that the full price would be forthcoming in three months (this was disputed by RTM who claimed they were told they would receive a promissory note for the additional \$70,000 secured by a second mortgage).<sup>74</sup>

In a subsequent action by ITT to foreclose the mortgage on the property, the trial court found that the Zimmers' deed was never delivered and that no right, title or interest ever passed to RTM or ITT.<sup>75</sup> On appeal, ITT presented two arguments: (1) that the words at the top of the deed created only an equitable lien on the property for the purchase price; and (2) in any event, the Zimmers were estopped by not returning any of the benefits received in exchange for the property.<sup>76</sup> With regard to the first argument the court agreed that an express reservation in a conveyed deed only creates an equitable interest, but pointed out that this rule applies only when the deed has been delivered.<sup>77</sup> Delivery is a question of intent and here the intent of the grantors is clear. The Zimmers did not intend the deed to operate as a conveyance until all the consideration had been paid, and where the intent of the grantor is clear it must be given effect.<sup>78</sup> With regard to the second argument, the court observed that the Zimmers were not estopped because they were unaware of all the facts when they accepted the down payment.<sup>79</sup> In dictum, the court noted that RTM might have an action against the Zimmers for the return of the down payment money but that this issue was not before the court.<sup>80</sup>

## V. EASEMENTS AND LICENSES

### A. *Revocability of Licenses and Damages for Revocation*

Although licenses and easements often involve similar types of land use, they are different in several important respects. An easement,

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73. *Id.* at 203.

74. *Id.* at 204.

75. *Id.*

76. *Id.* at 203-04.

77. *Id.* at 204.

78. *Id.*

79. *Id.*

80. *Id.* at 205.



being viewed as a conveyance of an interest in land, comes within the Statute of Frauds; whereas, a license, being viewed as a mere privilege to use the land of another, can be created orally. The easement, being a conveyance of an interest in land, is perpetual unless the terms of the grant expressly or by implication indicate the estate is determinable; whereas, the license, being a mere privilege to use the land, is revocable by the licensor at any time.<sup>81</sup> Although an easement comes within the Statute of Frauds, it can be acquired by prescriptive use just as title to land can be acquired by adverse possession.<sup>82</sup> Likewise, the courts have generally recognized that an easement, like other interests in land, can be created by estoppel or part performance.<sup>83</sup>

Where a licensee relies to his detriment on the oral promise of a licensor by expending funds or making improvements to the land, courts often find the license has become "irrevocable" or an "oral easement."<sup>84</sup> The question of the revocability of a license is raised in *Closson Lumber Co. v. Wiseman*.<sup>85</sup> In 1948 the Closson Lumber Co. (Closson) orally agreed to allow Wiseman to use its unimproved tract of land for ingress and egress to Wiseman's warehouse. Based upon this gratuitous promise, Wiseman installed an overhead door in the north wall of the warehouse, blacktopped Closson's land, and erected a fence on Closson's north property line. In 1981, Closson notified Wiseman that he could no longer use its land to reach the warehouse. Wiseman filed for a declaratory judgment, and the trial court found that he had nothing more than a revocable license.<sup>86</sup> On appeal, in a memorandum opinion (*Closson I*), the court of appeals found that the license had ripened into an oral easement, but concluded that the easement could be revoked if Wiseman was compensated.<sup>87</sup> On remand,

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81. CUNNINGHAM, *supra* note 3, § 8.1, at 437; *Richter v. Irwin*, 28 Ind. 26 (1867) (easement is an interest in land).

82. CUNNINGHAM, *supra* note 3, § 8.7, at 450-56. In Indiana an easement by prescription can be acquired by open, continuous, adverse use for twenty years. IND. CODE. § 32-5-1-1 (1988).

83. CUNNINGHAM, *supra* note 3, § 8.8 at 456-58; *Dubois County Machine Co. v. Blessinger*, 149 Ind. App. 594, 274 N.E.2d 279 (1971) (recognizing an oral easement under the doctrine of part performance).

84. *E.g.*, *Stoner v. Zucker*, 148 Cal. 516, 83 P. 808 (1906); *Mueller v. Keller*, 18 Ill. 2d 334, 164 N.E.2d 28 (1960); *Holbrook v. Taylor*, 532 S.W.2d 763 (Ky. 1976); *Maxwell v. Bay City Bridge Co.*, 41 Mich. 453, 2 N.W. 639 (1879); *Ricenbaw v. Kraus*, 157 Neb. 723, 61 N.W.2d 350 (1953); *Shepard v. Purvine*, 196 Or. 348, 248 P.2d 352 (1952); *Rerick v. Kern*, 14 Serg. & Rawle 267 (Pa. 1826).

85. 507 N.E.2d 974 (Ind. 1987).

86. *Id.* at 975.

87. *Id.* It is interesting to speculate why the court did not conclude the license had become an irrevocable easement. *See* CUNNINGHAM, *supra* note 3, § 8.8, at 456-

the trial court found the proper measure of damages to be the difference between the value of the Wiseman property with the easement and the value of the property without the easement, and that “any lost profits and future earnings, proposed alterations and appraisals might be relevant in arriving at those values.”<sup>88</sup> The trial court then concluded that the decrease in the market value of Wiseman’s property was \$45,000—the cost of extending the warehouse to the west to provide an alternate means of ingress and egress to the business.<sup>89</sup> The Court of Appeals in a second memorandum opinion (*Closson II*) affirmed.

On petition for transfer, the Indiana Supreme Court disagreed with the court of appeals’ characterization of the interest as a “revocable easement,” noting that if the interest is revocable it is more properly termed a license.<sup>90</sup> While the court agreed that compensation could be awarded upon revocation of the license, the court disagreed with the court of appeals on the measure of damages. Noting with approval the dissenting opinion by Judge Sullivan in *Closson II*, the court concluded that the award of damages should be limited to the amounts expended upon the disputed parcel, and that consequential damages such as the prospective expenditures to remodel appellee’s warehouse should not be considered.<sup>91</sup> Thus, the trial court’s award of damages was excessive, the opinion of the court of appeals was vacated, and the case was remanded to the trial court.<sup>92</sup>

In a dissenting opinion, Justice DeBruler observed that the license was to last so long as Wiseman might need it, and that in reliance

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58. Interestingly enough, the position taken by the court is similar to that recommended by the Restatement of Property. RESTATEMENT OF PROPERTY § 519(4) (1944). The Restatement would allow the license to become an easement, but instead of becoming irrevocable, the easement would last only as long as necessary for the grantee to recover any loss resulting from the detrimental reliance. Here, the court is awarding damages directly instead of granting specific performance for a time period sufficient to accomplish the same purpose, a return to the *status quo*.

88. *Closson*, 507 N.E.2d at 975.

89. *Id.* at 976.

90. *Id.* at 977.

91. *Id.* It is not clear why the court believed plaintiff’s recovery was limited to expenditures on the defendant’s land. This might be based upon an assumption that expenditures made upon the plaintiff’s property will be retained by the plaintiff and therefore there is no reason for him to be compensated. In reality, the facts suggest that plaintiff will be left with an overhead door of little or no value without the license or additional expenditures. Clearly the improvements were made for use with the license and without the license the improvements would not have been made.

92. The court observed that the appellee paid no consideration for the oral agreement, never paid the real estate taxes or other assessments on the land, and never compensated appellant for the use of the property. *Id.*



on this promise he expended capital and labor on both the dominant and servient tenements.<sup>93</sup> These facts led the court of appeals to conclude in *Closson I* that compensation was due Wiseman for the revocation and this became the law of the case.<sup>94</sup> Restitution is intended to restore the parties to an equivalent position. In Justice DeBruler's view, the majority opinion does not do this because it fails to take into consideration improvements made on the dominant estate in reliance on the promised license.<sup>95</sup> Justice DeBruler stresses the point with an example of a farmer who allows his neighbor to cross his land to reach the neighbor's field. The farmer then watches his neighbor plow and plant the field and when the work is done, the farmer revokes the license before his neighbor can harvest his crops. How can the neighbor be restored to the *status quo* without recovery of his investments on his own land?<sup>96</sup>

*B. Statute of Frauds: Easement Created by Grantee in Deed Poll*

In *Chase v. Nelson*,<sup>97</sup> a 1921 deed from William and Fannie Ledbetter (the Chases' predecessors in title) to Lenore Alspaugh (the Nelsons' predecessor in title) provided that the grantors and the grantee each agreed to furnish three feet and five inches of land for the use of a common driveway between their lots. The three feet and five inches was to be taken off the east side of the grantors' lot and off the west side of the grantee's lot and was to extend for a distance of seventy-eight feet.<sup>98</sup> The Chases filed this action alleging the Nelsons had interfered with the use of the common driveway by continuously parking cars on it. The trial court found the Chases had no easement over the Nelsons' property because (1) the 1921 deed failed to identify the dominant and servient tenements and (2) it was not signed by Alspaugh, the Nelsons' predecessor in interest.<sup>99</sup>

On appeal, the court found that the wording in the 1921 deed adequately described the dominant and servient tenements by the reservation of an easement in favor of the grantors on the three-foot five-inch strip on the west side of the property conveyed to Alspaugh and by the grant to Alspaugh of an easement over the three-foot five-

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93. *Id.* at 978 (DeBruler, J., dissenting).

94. *Id.* The majority opinion held that the court of appeals reversal in *Closson I* did not decide the scope of damages to be awarded upon revocation of the license. *Id.* at 977.

95. *Id.* at 978 (DeBruler, J., dissenting).

96. *Id.*

97. 507 N.E.2d 640 (Ind. Ct. App. 1987).

98. *Id.* at 641.

99. *Id.* at 641-42.

inch strip of land on the east side of the land retained by the Led-betters.<sup>100</sup> With regard to the Statute of Frauds requirement that the conveyance of an interest in land must be signed by the party to be charged,<sup>101</sup> the court concluded that this requirement does not apply when an interest is conveyed by the grantee in a deed.<sup>102</sup> Acceptance of the deed by the grantee brings the easement into existence without any further act on the part of the grantee. Acceptance of the deed is acceptance of the express easement created in the deed.<sup>103</sup> Having found the easement valid, the court remanded the case for further findings of fact as to whether the Nelsons' interference, if any, justified the granting of injunctive relief.<sup>104</sup>

*C. Prescriptive Easement: Quiet Title Action as Res Judicata*

In *Popp v. Hardy*,<sup>105</sup> Louis Popp, now deceased, brought an action to enjoin interference with an alleged twenty-foot prescriptive right-of-way across the land of Claude and Rose Hardy (Hardys).<sup>106</sup> The trial court granted the Hardys' motion for a summary judgment.<sup>107</sup> In so doing, the trial court found that (1) a 1966 quiet title decree quieting title to the disputed strip of land in Carl and Myrtle Elrod (the Elrods), the Hardys' predecessors in title, operated to foreclose Popp's claim to a prescriptive easement, and that (2) Popp's use of the right-of-way was permissive and not adverse.<sup>108</sup> Popp appealed.

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100. *Id.* at 642-43.

101. IND. CODE § 32-2-1-1 (1988) provides:

No action shall be brought . . . [u]pon any contract for the sale of lands . . . [u]nless the promise, contract or agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith.

102. *Chase*, 507 N.E.2d at 643.

103. *Id.* While the court could find no Indiana cases directly on point, it did find two cases which could be used by analogy as authority. In *Thiebaud v. Union Furniture Co.*, 143 Ind. 340, 42 N.E. 741 (1895), the court found a contract written in a deed with the knowledge and consent of the grantee was equivalent to a signature on the contract. Similarly, in *Brendonwood Common v. Franklin*, 403 N.E.2d 1136 (Ind. Ct. App. 1980), the court held that a covenant running with the land was binding on the grantee of a deed poll because the acceptance of the deed satisfies the statute of frauds and imposes the undertakings in the deed upon the grantee.

104. *Chase*, 507 N.E.2d at 644.

105. 508 N.E.2d 1282 (Ind. Ct. App. 1987).

106. After Louis' death, his two children, James Popp and Ruth Sipes (James and Ruth), as co-executors of their father's estate, were substituted as party plaintiffs. *Id.* at 1284.

107. *Id.*

108. *Id.* The trial court also found that the alleged easement was not sufficiently described. *Id.* However, on appeal, the court summarily concluded that the easement was sufficiently described for purposes of creating an issue in a summary judgment proceeding. *Id.* at 1287.



The first issue addressed on appeal was the trial court's finding that the quiet title decree of October 18, 1966, was *res judicata* with regard to Popp's claim. If the 1966 decree was *res judicata*, it would foreclose Popp's claim to a prescriptive easement, because acquisition of a prescriptive easement requires actual, hostile, open, notorious, continuous, uninterrupted, and adverse use for twenty years under a claim of right with the knowledge and acquiescence of the owner,<sup>109</sup> and twenty years had not elapsed between the date of the decree and Popp's action. In finding the decree was not *res judicata*, the court noted that while the complaint in the quiet title action filed by Bertha Earl is styled "Complaint To Quiet Title Against The World," it named specific defendants, including the Elrods, and listed specific defects in the title from 1850 to 1954 by book and page number.<sup>110</sup> Popp was not named as a party in the action nor was his prescriptive easement listed as a defect in title.<sup>111</sup> The Hardys argued that Popp was included within the complaint by the words "as well as all persons who might assert any title, claim, or interest in and to the real estate, all of whom are unknown to the plaintiff."<sup>112</sup> The court rejected this argument pointing out that it was difficult to see how a person openly using the plaintiff's land could be "unknown."<sup>113</sup> The court observed that

Before *res judicata* operates to bar a subsequent action it must be shown: (1) that the prior court had jurisdiction; (2) the matter now in issue was or might have been determined in the prior suit; (3) that the former controversy was between the same parties or their privies; and (4) that the prior judgment was issued on the merits.<sup>114</sup>

In this case, Popp was not named as a party nor did the suit by Earl against the Elrods to determine fee simple title to the twenty-foot strip encompass Popp's claim to an easement over the same land. Since Popp's claim was adverse to the Elrods' interest, he was not represented in the suit nor was a judgment entered on the merits.<sup>115</sup> Thus, the quiet title action was not *res judicata*.

On the issue of whether Popp's use of the land was permissive and not adverse, the Hardys argued that the admission in the deposition

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109. *Id.* at 1288 (citing IND. CODE § 32-5-1-1 (West 1982); *Searcy v. LaGrottee*, 175 Ind. App. 498, 372 N.E.2d 755 (1978)).

110. *Popp*, 508 N.E.2d at 1285.

111. *Id.* at 1285-86.

112. *Id.* at 1285.

113. *Id.* at 1287.

114. *Id.* at 1286 (citing *American National Bank & Trust Co. v. Hines* 143 Ind. App. 217, 239 N.E.2d 589 (1968)).

115. *Popp*, 508 N.E.2d at 1286.

of James Popp, Louis Popp's son, that after 1959 he and his father had asked permission from the Elrods and the Hardys to use the roadway is fatal to the claim of a prescriptive easement.<sup>116</sup> The Hardys argued that James should not be able to create an issue of fact with regard to the nature of the use by submitting an affidavit contradicting his own prior testimony. The court agreed with this general principle, but observed that in this case there is evidence corroborating James' affidavit, including the testimony of independent witnesses, some of whom were members of the families of predecessors in the Hardy's title. In addition, there was evidence that the prescriptive easement may have already existed by 1959.<sup>117</sup> The court concluded that a material question of fact existed and directed the trial court to overrule both motions for summary judgment and set the cause for trial on the merits.<sup>118</sup>

## VI. LANDLORD AND TENANT

### A. *Breach of Lease: Termination*

Under traditional landlord-tenant law, the breach of a lease provision by one of the parties does not permit the other party to terminate the lease absent a statute or an express provision in the lease so providing.<sup>119</sup> Leases, however, often contain a "forfeiture" provision giving one party, usually the landlord, the power to elect to treat the breach of a material lease provision by the other as a termination of the lease.<sup>120</sup> In such a case, the leasehold comes to an end and the

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116. *Id.* at 1287. A prescriptive easement is acquired by actual, hostile, open, notorious, continuous, uninterrupted, and adverse use for twenty years under a claim of right. IND. CODE § 32-5-1-1 (1988).

117. *Popp*, 508 N.E.2d at 1288. Since 1928, Louis and his son James had used the roadway across Hardy's property to reach an adjoining fifteen-acre tract of land which Popp owned. Neither the Hardys nor their predecessors in title had ever complained of or objected to Popp's use of the right of way. *Id.* at 1284.

118. *Id.* at 1289.

119. CUNNINGHAM, *supra* note 3, § 6.76, at 393-95. As a general rule, a breach of a covenant in the lease does not work a forfeiture unless the lease so provides. *Churchwell v. Collier & Stoner Bldg. Co.*, 179 Ind. App. 357, 385 N.E.2d 492 (1979) (citing 49 AM. JUR. 2D, *Landlord and Tenant* § 1021 (1970)).

IND. CODE § 32-7-1-5 (1988) provides that the failure of the tenant to pay the rent when due shall terminate the lease upon ten-day notice to quit. Notice to quit is not required where the rent is payable in advance; where the term of the lease has expired; where a tenant at will has committed waste; in the case of a tenant at sufferance; or where the relation of landlord or tenant does not exist. IND. CODE § 32-7-1-7 (1988).

120. CUNNINGHAM, *supra* note 3, § 6.76, at 393-95. A forfeiture term will not be enforced, however, unless the breach goes to the heart of the contract. *Ogle v. Wright*, 172 Ind. App. 309, 360 N.E.2d 240, 244 (1977).



landlord can evict the tenant without any further notice.<sup>121</sup> The right of the landlord to terminate the lease and evict the tenant upon his breach of a lease provision was raised in two cases under review. In *Halliday v. Auburn Mobile Homes*,<sup>122</sup> tenant violated park rules prohibiting the keeping of dogs. Tenant was given a pamphlet containing the park rules and regulations and the rules and regulations were posted in the park. Landlord, upon discovering that tenant had a dog in his mobile home gave him ten-day notice to quit, and when he failed to do so filed an action for ejectment. The trial court ordered the tenant to vacate.<sup>123</sup>

On appeal, tenant argued he was entitled to one-month notice.<sup>124</sup> In rejecting this argument, the court observed that tenant had agreed in the contract that he could be ejected from the park for violation of any rules or regulations of the park which were properly posted.<sup>125</sup> Thus, the tenancy was terminated upon violation of the posted rules and the tenant was no longer entitled to notice.<sup>126</sup> The fact that he had found a home for the dog and that it would be expensive to move the double-wide mobile home did not impress the court. He who seeks equity must do so with clean hands.<sup>127</sup>

In *Page Two, Inc. v. P.C. Management, Inc.*,<sup>128</sup> the court addressed two issues which frequently arise in termination actions for breach of lease: (1) whether the breach is material; and (2) whether the landlord has waived the remedy of termination by his subsequent actions. Through a series of assignments, a group of corporations and individuals, referred to collectively as Page Two, acquired the principle lease on a building in Indianapolis. Prior to the assignment, the second floor of the building

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121. Since the termination ends the lease, the tenant becomes a tenant at sufferance and the landlord may proceed to evict the tenant pursuant to IND. CODE § 32-7-3-1 (1988). No notice is required to evict a tenant at sufferance. IND. CODE § 32-7-1-7 (1988).

122. 511 N.E.2d 1086 (Ind. Ct. App. 1987).

123. *Id.* at 1087.

124. Where the tenancy is from month to month, the tenant is entitled to one month's notice. IND. CODE § 32-7-1-3 (1988).

125. *Halliday*, 511 N.E.2d at 1087-88. In a footnote the court cited the statute specifically regulating mobile home parks, IND. CODE § 13-1-7-34 (1988), which provides, "The owner, operator, or caretaker of any mobile home park may eject any person from the premises . . . for the violation of any rule of the park which is publicly posted within the park." *Id.* at 1088 n.2

126. In effect the tenant becomes a tenant at sufferance when he remains in possession after the tenancy has expired. A tenant at sufferance can be evicted by the owner of the premises pursuant to IND. CODE § 32-7-3-1 (1988). No notice is required to evict a tenant at sufferance. IND. CODE § 32-7-1-7 (1988).

127. *Halliday*, 511 N.E.2d at 1089.

128. 517 N.E.2d 103 (Ind. Ct. App. 1987).

had been sublet to P.C. Management, Inc, who operated a comedy club on the sublet premises. Upon the assignment, Page Two became the sublessor. Subsequently, P.C. Management closed its comedy club in May 1986, but continued to use the subleased premises for storage. On September 8, 1986, P.C. Management sent a letter notifying Page Two that it intended to exercise the first two-year renewal option under the sublease for a term commencing on November 15, 1986. By letter dated October 29, 1986, Page Two notified P.C. Management that it was in default under the terms of the sublease, and by letter dated November 13, 1986, Page Two declared the lease terminated and demanded possession. Page Two subsequently refused to accept the monthly rental payment tendered by P. C. Management.<sup>129</sup>

Page Two alleged violations of paragraphs 7 and 8 of the sublease. Paragraph 7 provided that "Sublessee shall pay for utilities used as determined on the basis of the square footage of the sublet premises to the square footage of the premises, wherein such utilities are used."<sup>130</sup> When Page Two became sublessor, P.C. Management's portion of the utilities, based on the square footage computation, was determined to be 20 percent (20%). A few days after the comedy club moved in May 1986, Page Two had the air conditioning and heating duct work disconnected from the sublet premises. Nevertheless, in July 1986, P.C. Management received a statement for electricity from June 5, to July 7, 1986, computed on the 20% basis even though its actual use for this period was limited to one exit light, an alarm system, and an occasional use of lights. P.C. Management protested the charges as excessive and refused payment. In August and September 1986, Page Two again submitted 20% billings which P.C. Management again protested and refused to pay. Page Two did not respond to these protests or send further statements, but it did continue to accept the monthly rental payments.<sup>131</sup>

Paragraph 8 provided that "Sublessee shall maintain fire, casualty and personal injury insurance. . . ."<sup>132</sup> P.C. Management cancelled its general liability insurance coverage in June 1986, after it had closed the comedy club. The court noted that Page Two had never inquired about or requested proof of insurance coverage until the letter dated October 29, 1986, advising P.C. Management that it was in default of the sublease agreement. On November 18, 1986, P.C. Management made a conditional offer to reinstate the general liability insurance which Page Two refused.<sup>133</sup>

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129. *Id.* at 104-05.

130. *Id.* at 105.

131. *Id.* at 104.

132. *Id.* at 105.

133. *Id.* at 104-05.



In an action by Page Two for a declaratory judgment, the court awarded possession to P.C. Management on the theory that the sublessor had waived the right to terminate the sublease.<sup>134</sup> With regard to the utility dispute, the trial court found that by accepting the rent after each of the three protests, it had waived the utility dispute as a basis for termination. In addition, Page Two took no steps to resolve the issue and its stonewalling was not a mere delay in the exercise of its right of termination, but was delay coupled with knowledge that payment was not forthcoming.<sup>135</sup>

On appeal, Page Two argued that it could not have waived the right to terminate the lease for the nonpayment of utilities because the right to declare a default had not yet become fixed at the time it accepted the rent, and there can be no waiver based on the acceptance of a rental payment before the time the landlord has the right to forfeit the lease. Page Two appeared to be arguing that it had no right to declare a forfeiture under paragraph 18 of the sublease until it had given ten-day notice of default or unless the utilities had not been paid for thirty days.<sup>136</sup> The court rejected this argument pointing out that the statement from P.C. Management that the utilities would not be paid was an anticipatory breach of the utility provision which allowed the other party to treat the lease as terminated. Thus, the court found that Page Two's acceptance of the rent after the protest statement, constituted a waiver of the contractual right to terminate the sublease.<sup>137</sup>

With regard to the breach of the covenant to insure, the trial court likewise found that Page Two had waived the insurance default, but in addition concluded that "[t]he matter of insurance was a minor default . . . which does not justify the forfeiture of the Sublease Agreement. . . ."<sup>138</sup> On appeal, the court affirmed the trial court decision on the alternative ground of lack of material breach.<sup>139</sup> A provision in a lease allowing the breach of a covenant to work a forfeiture will be enforced only if the breach is material. To determine whether or not the breach is material the court turned to the Restatement of Contracts 275, cited with approval in *Goff v. Graham*.<sup>140</sup> Factors to be considered are:

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134. *Id.* at 105-07.

135. *Id.* at 107.

136. *Id.* at 105.

137. *Id.* at 107.

138. *Id.* (quoting Record at 163).

139. *Id.* at 107-08.

140. 159 Ind. App. 324, 306 N.E.2d 758 (1974).

- (a) The extent to which the injured party will obtain the substantial benefit which he could have reasonably anticipated;
- (b) The extent to which the injured party may be adequately compensated in damages for lack of complete performance;
- (c) The extent to which the party failing to perform has already partly performed or made preparations for performance;
- (d) The greater or lesser hardship on the party failing to perform in terminating the contract;
- (e) The wilful, negligent, or innocent behavior of the party failing to perform;
- (f) The greater or lesser uncertainty that the party failing to perform will perform the remainder of the contract.<sup>141</sup>

In examining the alleged breach under the Restatement standards, the court concluded that the evidence did not lead to a conclusion contrary to that reached by the trial court. Page Two suffered no loss as a result of the omitted insurance coverage, the use of the premises by the sublessee after termination of the insurance coverage did not present a significant risk of loss to Page Two; Page Two never concerned itself with the question of insurance and P.C. Management offered to reinstate the coverage.<sup>142</sup> The decision of the trial court was affirmed.

### *B. Crops as Rent*

In Indiana, the landlord-tenant relationship itself does not create a lien on the personal property of the tenant for the payment of rent apart from a statute or agreement providing otherwise.<sup>143</sup> Indiana Code section 32-7-1-18, however, provides that the landlord may acquire a lien on crops grown by the tenant where the tenant has agreed to pay as rent a part of the crops grown.<sup>144</sup> The nature of the lien and the

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141. *Page Two*, 517 N.E.2d at 107-08 (quoting RESTATEMENT OF CONTRACTS § 275) (1979)).

142. *Page Two*, 517 N.E.2d at 108.

143. *E.g.*, *Cowles v. Bick*, 191 Ind. 243, 131 N.E. 36 (1921); *Schuler v. Langdon*, 433 N.E.2d 841, 845 n.4 (Ind. Ct. App. 1982); *Cannon v. Northside Transfer Co., Inc.*, 427 N.E.2d 712 (Ind. Ct. App. 1981); *Highland Realty, Inc. v. Indianapolis Morris Plan, Corp.*, 136 Ind. App. 208, 216, 199 N.E.2d 110, 114 (1969).

There are at least two statutory provisions which give a landlord a lien on the tenant's property for the nonpayment of rent. IND CODE § 32-7-1-18 (1988) provides that the landlord may acquire a lien on crops grown on the leased premises where the tenant has agreed to pay a part of the crop as rent. IND. CODE § 13-1-7-33 (1988) provides that the owner, operator or caretaker of a mobile home park shall have an innkeeper's lien upon the property of the the person renting the lot for the nonpayment of rent. *See Nicholson's Mobile Home Sales, Inc. v. Schramm*, 164 Ind. App. 598, 330 N.E.2d 598 (1975).

144. IND. CODE § 32-7-1-18 (1988).



requirements for its perfection were raised in *Farm Bureau Co-Op v. Deseret Title Holding Corp.*<sup>145</sup> Tenant leased 1030 acres of land from Deseret Title Holding Corporation (Deseret) and agreed to pay as annual rent for 1983 "50 bushels of #2 yellow grade corn per acre."<sup>146</sup> The lease also provided that in the event of a crop disaster from natural causes, defined "as a year in which the county average production as reported by USDA falls 30% below the most recent 5 year (sic) USDA average for the county for the grain being produced," the tenant could deliver 50% of the crop in lieu of the bushel rent stated in the lease.<sup>147</sup> The Montgomery County Farm Bureau Cooperative Association (Co-Op) agreed to supply fertilizers and chemicals to the tenant to put the crops out in exchange for a security interest on the crops to be grown in 1983, which it would hold until tenant paid for the materials. The crop yield was much lower than expected and when payment was not forthcoming, Co-Op filed suit to foreclose its security interest, naming Deseret and others who might have an interest in the crop. Deseret filed an answer claiming a 50% interest in the crop. The trial court agreed and Co-Op appealed.<sup>148</sup>

The court began by pointing out that a lease of farmland which provides that the tenant is to pay as rent a certain number of bushels of grain per acre is a "crop paid as rent" agreement which does not vest any title to the crops in the landlord.<sup>149</sup> Whereas an agreement by the tenant to pay the landlord a percentage of the crop to be grown is a "crop share" arrangement which places the landlord and tenant in the position of tenants in common of the grain and gives the landlord a right to his share of the property "as soon as the grain was put into sacks."<sup>150</sup> Reviewing the lease in this case, the court concluded that it was a crop paid as rent agreement and not a crop share agreement.<sup>151</sup> In dictum, the court stated that even if Deseret had proven the existence of crop disaster conditions allowing the tenant to pay 50 percent of the crop in lieu of the bushel rent, the bushel provision in the lease would still have prevented it from being construed a crop share agreement.<sup>152</sup> Thus, to acquire a lien on the crop the landlord must comply with the provisions of Indiana Code section 32-7-1-18(b) and file in the recorder's office in the county in which the

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145. 513 N.E.2d 193 (Ind. Ct. App. 1987).

146. *Id.* at 194.

147. *Id.* at 195-96 n.1

148. *Id.* at 194-95.

149. *Id.* at 195.

150. *Id.*

151. *Id.* at 195-96.

152. *Id.* at 196.

lease premises is located, at least thirty days prior to the maturity of the crop and during the year in which the crop is grown, notice of his intent to hold a lien upon the crop in the amount of the rent. Since this was not done, the landlord had no lien on the crops and the judgment of the trial court was reversed and remanded.<sup>153</sup>

### C. *Holdover Tenants*

When a tenant holds over beyond the term of a lease, the landlord has three options: (1) the landlord can treat the tenant as wrongfully holding over; (2) the landlord can offer the tenant a new lease; or (3) the landlord can treat the lease as continuing, in which case the expired lease continues to operate for a new term equal to the length of the original term, except that where the term of the original lease was for more than a year, the holdover term is from year to year.<sup>154</sup> Where the landlord takes no action to evict the tenant and continues to accept the rent when it is tendered, it is presumed that the landlord has chosen option (3). In such a case, the terms and conditions of the original lease will continue to operate during the hold-over term.<sup>155</sup> This latter point was dramatically illustrated in *Penmanta Corp. v. Hollis*.<sup>156</sup> Edward Hollis and his wife operated a business known as the Toy Chest in Nashville, Indiana. In addition to selling toys, crafts and collectibles, the business included a miniature circus exhibit which Hollis had hand carved in quarter-inch scale portraying the Hagenbeck-Wallace Circus as it appeared in 1934. Hollis charged a small fee to view the exhibit.<sup>157</sup>

The business was located in a building owned by the Penmanta Corporation (Penmanta). The three-year written lease between Hollis and Penmanta expired on December 31, 1982, but Hollis remained in possession and continued to operate the business. On August 13, 1983, the hand-carved miniature circus was damaged in a fire caused by the failure of the landlord to maintain the premises. The expired lease contained an exculpatory clause which barred any claim against Penmanta for damage or injury to Hollis or his property resulting from the failure of Penmanta to keep the premises in repair.<sup>158</sup> In reversing a jury verdict and judgment in favor of Hollis, the court concluded

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153. *Id.*

154. *City of Bloomington v. Kurzuzovich*, 517 N.E.2d 408, 411 (Ind. Ct. App. 1987).

155. *Id.*

156. 520 N.E.2d 120 (Ind. Ct. App. 1988).

157. *Id.* at 121.

158. *Id.*



that "when a tenant holds over [at the end of the term], and the lessor does not treat the tenant as a trespasser by evicting him," absent an agreement to the contrary, "the parties are deemed to have continued the tenancy under the terms of the expired lease."<sup>159</sup> The court rejected Hollis' argument that because a provision in the lease required the written consent of Penmanta to hold over under the lease and this was not done, this rebutted the legal presumption that the parties intended to continue under the terms of the expired lease. The court found that the waiver of this provision by the landlord did not show a contrary intention.<sup>160</sup> Penmanta unconditionally accepted the rent and allowed Hollis to continue in possession some eight and a half months after the lease had expired before the fire occurred. Thus, the general rule applied that when a tenant holds over beyond the term of the lease, the lease is renewed under the same terms and subject to the same conditions as the original lease, including the exculpatory clause. The only change being that if the original lease is for a term of more than one year, the holdover term is from year to year. The court concluded the trial court was in error in not granting Penmanta's motion for summary judgment and reversed and remanded the case.<sup>161</sup> In a concurring opinion, Judge Sullivan noted that perhaps "contractual provisions particularly disfavored in the law, such as an exculpatory provision, might be excluded from the terms and conditions of a holdover tenancy" but that such a determination should come from the General Assembly or the Indiana Supreme Court.<sup>162</sup>

## VII. RECORDING: CONSTRUCTIVE NOTICE

Traditionally, the recording of an instrument not entitled to be recorded is not constructive notice of the interest created in the instrument. Thus, a subsequent purchaser for value without actual knowledge of the instrument (b.f.p.) will take the property free of the interest.<sup>163</sup> This rule has been criticized for protecting those who negligently fail to search the public records while charging those who diligently search the public records with actual notice of anything they discover as a result of the search.<sup>164</sup> The question of whether the

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159. *Id.* at 122 (quoting *Mooney-Mueller-Ward, Inc. v. Woods*, 175 Ind. App. 302, 305 n.1., 371 N.E.2d 400, 403 n.1. (1978)).

160. *Penmanta*, 520 N.E.2d at 122.

161. *Id.* at 122-23.

162. *Id.* at 123 (Sullivan, J., concurring).

163. J. CRIBBET, *PRINCIPLES OF THE LAW OF PROPERTY* 219 (1962). In Indiana, to defeat the prior interest, the b.f.p. must also properly record his interest first under Indiana's race-notice recording act. IND. CODE § 32-1-2-16 (1988).

164. J. CRIBBET, *supra* note 163, at 220.

recording of an instrument not entitled to be recorded should operate as constructive notice was raised in *In Re Sandy Ridge Oil Co., Inc.*<sup>165</sup>

Sandy Ridge Oil Company (Sandy Ridge) executed mortgages on its oil and gas leases on six oil wells (only one mortgage is in issue) as security for the payment of the note to Halliburton Services. (Halliburton). In a subsequent Chapter 11 bankruptcy proceeding, the debtor in possession sought to avoid the mortgage under 544(a)(3) of the Bankruptcy Code,<sup>166</sup> which permits a trustee to avoid any transfer voidable by a b.f.p. Sandy Ridge argues that the mortgage was voidable because the name of the person who prepared the instrument was not included as required by Indiana Code section 36-2-11-15(b), and thus its recording did not provide constructive notice.<sup>167</sup> The United States Court of Appeals for the Seventh Circuit certified the question of constructive notice to the Indiana Supreme Court under Rule 15(O) of the Indiana Rules of Appellate Procedure:

Does a recorded instrument conveying . . . or otherwise disposing of an interest in or lien on property that does not disclose the name of the preparer as required by Ind. Code 36-2-11-15(b) nevertheless impart constructive notice to a bona fide purchaser?<sup>168</sup>

The Indiana Supreme Court began by noting that while there are no Indiana cases specifically addressing the effect of the recording of an instrument without the name of the preparer as required by the statute, the general rule is that the recording of an instrument not entitled to be recorded does not afford constructive notice, citing numerous cases in support of this principle.<sup>169</sup> But the court also noted that the cases offered no supporting rationale for the rule.<sup>170</sup> Halliburton argued that the legislature did not intend a strict interpretation of Indiana Code section 36-2-11-15(b) (Section 15) and offered as support for this position the curative provision of Indiana Code section 36-2-11-16 (Section 16) which provides that the receiving and recording of an instrument by the county recorder is conclusive proof of compliance with Section 16.<sup>171</sup> Appellee argued that the existence of the curative provision in Section 16 but not in Section 15 shows an intent to exclude the curative provision from Section 15. The court observed that the

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165. 510 N.E.2d 667 (Ind. 1987).

166. 11 U.S.C. § 544(a)(3) (1982).

167. IND. CODE § 36-2-11-15(b) (1988).

168. *Sandy Ridge*, 510 N.E.2d at 669-70.

169. *Id.* at 669.

170. *Id.*

171. IND. CODE. § 36-2-11-15(b) (1988); IND. CODE § 36-2-11-16 (1988).



two sections were enacted separately and that they have not been subsequently considered as companion sections. The curative provision of Section 16 predated the requirement of the preparer's name in Section 15, and thus, it can not be argued that the curative provision was drafted either to exclude or apply to the omission of the preparer's name.<sup>172</sup>

Halliburton also argued that the only reason for the requirement that the preparer's name be noted on the instrument was to guard against the unauthorized practice of law, and thus Section 15 should not be given the strict interpretation urged by the Appellee. The court agreed, observing that the omission of the name of the preparer does not affect the validity of the conveyance or encumbrance.<sup>173</sup> All the requirements necessary for a valid conveyance or encumbrance appear on the face of the instrument and the noting of the preparer's name "does not enhance the protection of any particular identifiable property interest."<sup>174</sup> Also, the legislature failed to indicate the legal consequences which should flow from a violation of the statute, which in the opinion of the court suggested that "[i]f the General Assembly intended to strip a mortgagee of his rights as against a subsequent purchaser . . . it chose to express that intention in a very guarded way."<sup>175</sup> The court then cited, *Bown & Sons v. Honabarger*,<sup>176</sup> an Ohio Supreme Court decision holding that the purpose of a nearly identical statute was to prevent the unauthorized practice of law.<sup>177</sup> Since enactment of Section 15 "came on the heels of the Ohio statute," the court speculated that Section 15 "may well have been based in substance and purpose on the Ohio statute,"<sup>178</sup> and that the deterrence of the unauthorized practice of law "bears no relation to the legality of the conveyance or encumbrance," and "should not invalidate the clear and undoubted notice which record of the instrument imparts."<sup>179</sup> Having reached this conclusion, the court answered the certified question in the affirmative, that the recordation of an instrument not complying with the requirements of Section 15 imparts constructive notice to a subsequent purchaser.<sup>180</sup>

One question left partially unanswered by the court is whether any of the other statutory requirements for recording will be held to be

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172. *Sandy Ridge*, 510 N.E.2d at 669-70.

173. *Id.* at 670.

174. *Id.*

175. *Id.* at 671.

176. 171 Ohio St. 247, 168 N.E.2d 880 (1960).

177. *Id.*

178. *Sandy Ridge*, 510 N.E.2d at 671.

179. *Id.*

180. *Id.*

exempt from the general rule. The court did issue a *caveat* suggesting that not all defects would be ignored:

We emphasize that the recording requirements which affect the nature of the interest and the formalities of execution, if absent from a recorded instrument, will not be excused so as to permit the improper document to be afforded constructive notice. By our decision today, we hold only that the omission of the preparer's name, contrary to the requirements of Section 15, does not operate to deprive a recorded document of the constructive notice to which it would otherwise be entitled.<sup>181</sup>

In a dissenting opinion, in which Justice Givens concurred, Justice Pivarnik observed that the wording of the statute is clear and unambiguous. A mortgage may be received for recordation only if the name of the person who prepared the instrument is indicated at the end of the document. It is presumptuous for the court to attempt to determine the purpose of the legislation absent any ambiguity in the statute.<sup>182</sup>

#### VIII. RULE AGAINST PERPETUITIES

In *Brown v. American Fletcher National Bank*,<sup>183</sup> testator's daughter Zilpha, the income beneficiary of a testamentary trust, alleged that the provision dividing the corpus of the trust among the testator's great-grandchildren violated the rule against perpetuities.

The provisions of the trust required the trustee to pay the income from the trust to Zilpha so long as she should live. Upon her death, trustee was to divide the principal of the trust between three named great-grandchildren (Guy Allen Brown, Danny Jay Brown, and Barry Jon Brown) and any afterborn children of the marriage of Norman S. Brown and Nancy Brown. There was also a provision for the issue of any great-grandchildren not surviving. If any of the great-grandchildren were twenty-five years of age at Zilpha's death, the trustee was to distribute to said great-grandchild his respective share. Until each great-grandchild attained the age of twenty-five the trustee was to "pay the net income from the respective funds to said grandchild as the Trustee may deem advisable to provide properly for his welfare."<sup>184</sup>

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181. *Id.*

182. *Id.* at 671-73 (Pivarnik, J., dissenting).

183. 519 N.E.2d 166 (Ind. Ct. App. 1988).

184. *Id.* at 167.



On appeal from a summary judgment upholding the trust, Zilpha argued that her father's testamentary scheme violated the rule against perpetuities because the interest of a great-grandchild might vest more than twenty-one years after the death of the lives in being at the testator's death.<sup>185</sup> Zilpha relied on *Merrill v. Wimmer*,<sup>186</sup> as authority for her position. In *Merrill*, the provision of a testamentary trust distributing the corpus to the testator's grandchildren when the youngest grandchild reached the age of twenty-five was held to violate the rule and the trust was declared void.<sup>187</sup>

The court observed that while the wording of the trust in *Merrill* may at first appear similar, in fact, the two trusts are fundamentally different. In *Merrill* the income from the trust was to be paid to the children and the right to the principal of the trust did not vest in the grandchildren until the youngest grandchild reached the age of twenty-five, a period beyond the rule. In this case, upon the death of the life tenant the trust is to be divided into individual shares and each great-grandchild is to have an immediate right to the income from his respective share and an absolute right to receive his respective share of the corpus upon reaching the age of twenty-five. The immediate right of a beneficiary to all or a part of the income from the corpus of the trust is an indication that his interest in the corpus is vested.<sup>188</sup>

Zilpha's final argument dealt with the class gift problem and what is known as the "all or nothing" rule. In order for a class gift to be valid, the interest of each member of the class must vest within the rule. If the interest of even one member of the class can vest beyond the period of the rule, the entire gift fails.<sup>189</sup> Zilpha argued that since great-grandchildren could be born more than twenty-one years after the death of the lives in being at the creation of the interest the entire interest failed. This argument at first appears valid, but, as the court noted, the gift is to named great-grandchildren and the afterborn children of the marriage of Norman and Nancy Brown.<sup>190</sup> Thus the wording of the trust limits the class of beneficiaries to a group of great-grandchildren that are alive (named) or who will be determined within the lifetime of Norman and Nancy Brown (lives in being). In

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185. The rule requires that an interest "must vest, if at all, no later than twenty-one (21) years after a life or lives in being at the creation of the interest." IND. CODE § 32-1-4-1 (1988).

186. 481 N.E.2d 1294 (Ind. 1985).

187. *Id.*

188. *Brown*, 519 N.E.2d at 168; see also L. SIMES, THE LAW OF FUTURE INTERESTS § 93, at 192-93 (2d ed. 1966).

189. L. SIMES, *supra* note 188, at § 134, at 289-92.

190. *Brown*, 519 N.E.2d at 169.

addition, as the trustee argued, the trust is to be divided into shares at the death of Zilpha and thus, under the "rule of convenience," the class will close when it becomes reasonably necessary to do so.<sup>191</sup> The court observed that in either situation, Zilpha's death, as the trustee argues, or the death of Norman or Nancy Brown after which time no new members can be born, the class will close and the interests will vest within the rule.<sup>192</sup> The judgment of the trial court was affirmed.

#### IX. VENDOR-PURCHASER

In *Baker v. Townsend*,<sup>193</sup> a contract for sale with a condition precedent, the Townsends agreed to purchase a lot in Howard County from the Bakers "contingent upon obtaining a permit from the Health Department for the building of a house, well, and septic tank."<sup>194</sup> This provision was inserted into the real estate contract because, without a subsurface tile drain across land owned by others, the real estate could not be approved for a subdivision lot on which either a septic system or a house could be built.<sup>195</sup> While the wording of the contract made it contingent upon obtaining a permit from the County Health Department for the building of a house, well, and septic system, it was later determined that the permit to build a house is issued by the Howard County Plan Commission, although the permit cannot be issued unless the County Health Department first issues a permit for a septic system. Therefore, the court construed the contract as being contingent only upon the obtaining of a well and septic permit from the Howard County Board of Health, which would then make it possible to obtain the building permit.<sup>196</sup> No permit was ever obtained and the Townsends brought this action to rescind the contract based on fraud and failure of a condition precedent. The Bakers counterclaimed for the balance due under the contract. The trial court entered judgment for the Townsends rescinding the contract and returning them to the *status quo*.<sup>197</sup>

On appeal, the Bakers argued the contract created an implied duty on the part of the Townsends to make a reasonable and good faith

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191. T. BERGIN & P. HASKELL, PREFACE TO ESTATES IN LAND AND FUTURE INTERESTS 141-42 (2d ed. 1984).

192. *Brown*, 519 N.E.2d at 169. The court concluded that it was unnecessary to decide between the two interpretations as when the class will close but, if at Zilpha's death any of the grandchildren is then twenty-five years of age, the trustee will be forced to close the class in order to determine the amount to distribute. *Id.*

193. 519 N.E.2d 192 (Ind. Ct. App. 1988).

194. *Id.* at 193-94.

195. *Id.* at 193.

196. *Id.* at 194.

197. *Id.*



effort to obtain such permits, citing *Billman v. Hensel*,<sup>198</sup> which found such an implied obligation on the part of the buyer under a clause making the contract conditioned upon the ability of the purchasers to secure a conventional mortgage for not less than \$35,000 within thirty days. The court disagreed, pointing out that in *Billman* the financing clause was based upon the buyer's "ability" to acquire the loan. The condition in *Billman* created a covenant requiring the buyer to act; whereas in *Baker* the condition was silent as to the duty of either party to act.<sup>199</sup> The court also rejected the Bakers' argument that the Townsends should have been required to obtain the permits because of their "unique knowledge" concerning the proposed residence, pointing out that a similar argument could be made with regard to the Bakers because, as prior owners, their familiarity with the neighborhood placed them in a better position to approach the neighboring landowners to obtain the required easements.<sup>200</sup> Since the permits were not obtained within a reasonable time, either party had the right to rescind the contract and be returned to the *status quo*.<sup>201</sup> The judgment of the trial court was affirmed.

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198. 181 Ind. App. 272, 391 N.E.2d 671 (1979).

199. *Baker*, 519 N.E.2d at 195.

200. *Id.* at 195 n.1.

201. *Id.* at 195. The contract was executed on March 26, 1983, *id.* at 193, and the trial court found the reasonable time in which to fulfill the condition to have been the period prior to February 24, 1984. *Id.* at 195 n.2.

# Developments in Social Security Law

MICHAEL G. RUPPERT\*

## I. INTRODUCTION

During the survey period, the Seventh Circuit Court of Appeals decided three cases involving the standard for the evaluation of subjective claims of pain as a factor in the determination of social security disability cases. Whether these cases, *Meredith v. Bowen*,<sup>1</sup> *Veal v. Bowen*,<sup>2</sup> and *Walker v. Bowen*,<sup>3</sup> help to clarify this complex legal and social issue is questionable, for they stop short of the thorough analysis of the standard contained in *Luna v. Bowen*,<sup>4</sup> decided during the survey period by the Tenth Circuit. All four decisions demonstrate that the most notable development concerning this frequently litigated subject is the failure of the Social Security Disability Benefits Reform Act of 1984 (DRA)<sup>5</sup> to resolve the recurring conflict between the Social Security Administration ("Administration") of the Department of Health and Human Services and the various circuit courts of appeals concerning evaluation of claims of disabling pain.

The confusion in this area of the law poses significant problems for as many as one-half of all applicants for social security disability benefits,<sup>6</sup> their attorneys, the Administration's decisionmakers who adjudicate applications for disability benefits, and the federal courts which review the final decisions of the Secretary. This Article will review the legislation, regulations and case law pertaining to the issue, as well as selected findings contained in the *Report of the Commission on the Evaluation of Pain*,<sup>7</sup> prior to analyzing the *Meredith*, *Veal*, *Walker*, and *Luna* decisions. Suggestions derived from the analysis of the foregoing will be made by the author to assist the practitioner in his or her proof of disabling pain in the representation of social security disability claimants.

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\* Partner, Ruge & Ruppert, Indianapolis. B.A., Indiana University, 1974; J.D., Cleveland Marshall College of Law, 1977.

1. 833 F.2d 650 (7th Cir. 1987).

2. 833 F.2d 693 (7th Cir. 1987).

3. 834 F.2d 635 (7th Cir. 1987).

4. 834 F.2d 161 (10th Cir. 1987).

5. Social Security Disability Benefits Reform Act of 1984, Pub. L. No. 98-460, § 3, 98 Stat. 1794, 1799 (current version at 42 U.S.C. § 423 (Supp. IV 1986)).

6. R. GILBERT & J.D. TEETERS, SOCIAL SECURITY DISABILITY CLAIMS § 2:8A (1988).

7. COMMISSION ON THE EVALUATION OF PAIN, U.S. DEP'T OF HEALTH & HUMAN SERVICES, REPORT OF THE COMMISSION ON THE EVALUATION OF PAIN 121 (1986) [hereinafter REPORT OF THE COMMISSION ON THE EVALUATION OF PAIN].



## II. STATUTORY AND REGULATORY FRAMEWORK

For many years, the Social Security Act<sup>8</sup> and the regulations promulgated pursuant to the Act failed to provide any guidance regarding a claim that a disability applicant was functionally disabled due to pain. "Disability" was defined simply as the "inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months . . . ."<sup>9</sup> Since the Act requires a claimant to prove that his physical or mental impairment "results from anatomical, physiological, or psychological abnormalities which are demonstrable by medically acceptable clinical and laboratory diagnostic techniques,"<sup>10</sup> claimants alleging disabling pain were often denied benefits because of a lack of objective medical evidence substantiating their subjective symptoms.<sup>11</sup>

By 1980, some federal courts had clearly established that "subjective *pain* may serve as the basis for establishing disability, even if such pain

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8. Social Security Act, ch. 531, tit. I, § 1, 49 Stat. 620 (1935) (codified as amended at 42 U.S.C. § 401 (1982 & Supp. IV 1986)).

9. 42 U.S.C. § 423(d)(1)(A) (1982). As summarized by the court in *Veal v. Bowen*, the Social Security Administration's regulations required a fact-finder to consider a claim for disability benefits in the following sequence:

1. Is the claimant presently unemployed?
2. Is the claimant's impairment "severe"?
3. Does the impairment meet or exceed one of a list of specific impairments?
4. Is the claimant unable to perform his or her former occupation?
5. Is the claimant unable to perform any other work within the economy?

An affirmative answer leads either to the next step or, on steps 3 and 5, to a finding that the claimant is disabled. A negative answer at any point, other than step 3, stops the inquiry and leads to a determination that the claimant is not disabled.

*Veal v. Bowen*, 833 F.2d 693, 695 n.1 (7th Cir. 1987) (citations omitted). Because no specific listed impairment exists as yet for claims of severe pain, the evaluation of whether pain associated with a particular impairment is severe enough to result in disability necessarily occurs at step 4 and/or 5.

10. 42 U.S.C. § 423(d)(3) (1982). The relevant regulation within the subpart on disability determination, states that symptoms, signs, and laboratory findings all constitute medical findings. Symptoms are descriptions of the claimant's subjective physical or mental impairments such as pain, dizziness, shortness of breath and inability to concentrate. Signs are anatomical, physiological or psychological abnormalities observable by medical personnel using medically acceptable clinical diagnostic techniques. Laboratory findings include anatomical, physiological or psychological phenomena evidenced through the use of medically acceptable laboratory diagnostic techniques such as chemical tests, electrocardiograms, x-rays and psychological tests. 20 C.F.R. § 404.1528(c) (1988).

11. See Poskus, *Analyzing and Proving Subjective Pain for Social Security Disability Purposes*, 17 COLO. LAW. 475, 478 n.5 (1988).

is unaccompanied by positive clinical findings or other 'objective' medical evidence."<sup>12</sup> These cases typically involved either medical evidence of a persistent painful condition of an unknown etiology or a known medical condition which could reasonably be expected to produce some pain but not to the degree alleged by the claimant and his physician.<sup>13</sup>

As the case authority on the issue grew, the Administration promulgated a regulation in 1980 for the evaluation of subjective complaints, including pain.<sup>14</sup> Although the regulation required medical evidence of a condition which could reasonably be expected to produce the symptoms, it also required evaluation of the alleged disabling effect in light of the extent the symptom was confirmed by signs (abnormalities observable by physicians using standard diagnostic techniques) and laboratory findings (such as chemical tests, X-ray studies, etc.). In response to public concern that it was requiring objective measurement of pain, the Administration acknowledged for the first time that proof of a medical condition that can be expected to cause pain is all that is required.<sup>15</sup>

Unfortunately, the regulation failed to elucidate the extent to which signs and laboratory findings were necessary to substantiate allegations of disabling symptoms. By 1982 it became clear, however, that the Administration's emphasis in pain evaluation was not on the credibility of the claimant's testimony or his doctor's opinion about the functional limitations resulting from pain; rather, the regulation, as interpreted by Social Security Ruling 82-58,<sup>16</sup> placed the greatest weight on the re-

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12. *Marcus v. Califano*, 615 F.2d 23, 27 (2d Cir. 1979) (emphasis in original) (citations and footnotes omitted); see also *Celebrezze v. Warren*, 339 F.2d 833, 838 (10th Cir. 1964).

13. *Aubeuf v. Schweiker*, 649 F.2d 107, 113 (2d Cir. 1981) (error to require claimant to produce objective medical evidence of condition inevitably causing disabling pain); *Bartell v. Cohen*, 445 F.2d 80, 83 (7th Cir. 1971) (absence of hospitalization for degenerative arthritis not substantial evidence of ability to work); *Celebrezze v. Warren*, 339 F.2d at 838 (inability to determine etiology of well-documented severe pain does not constitute substantial evidence necessary to support denial of benefits).

14. 20 C.F.R. § 404.1529 (1988). "How we evaluate symptoms, including pain," provides as follows:

If you have a physical or mental impairment, you may have symptoms (like pain, shortness of breath, weakness or nervousness). We consider all your symptoms, including pain, and the extent to which signs and laboratory findings confirm these symptoms. The effects of all symptoms, including severe and prolonged pain, must be evaluated on the basis of a medically determinable impairment which can be shown to be the cause of the symptom. We will never find that you are disabled based on your symptoms, including pain, unless medical signs or findings show that there is a medical condition that could be reasonably expected to produce those symptoms.

*Id.*

15. 45 Fed. Reg. 55,576-77 (1980).

16. Unempl. Ins. Rep. (CCH) Soc. Sec., § 14,358 (October, 1982).



quirement of a medical basis to substantiate the claimed level of severity. Consequently, federal appellate review of the Administration's denial of benefits in cases involving pain continued as before with claimants contending that the Administration improperly required objective proof substantiating the severity of the pain alleged.<sup>17</sup> As before, claimants in other cases contended that their testimony or the opinions of their treating physicians with respect to the severity of their pain was rejected without substantial evidence to support the rejection.<sup>18</sup> The common thread throughout these cases is the determination that the level of pain claimed was not credible when viewed in light of the clinical signs and laboratory findings, *i.e.*, the "objective" medical evidence was insufficient, sometimes even if the severity was supported by opinion. The Act and regulations simply did not answer questions such as whether a paucity of medical signs and laboratory findings could be bolstered by strong, favorable medical opinion or credible testimony or whether the inability of the claimant to articulate the limitations caused by his symptoms would undermine the credibility of favorable medical opinions or strong medical evidence. Answers to these questions were not supplied by the DRA.

### III. THE "PAIN" STATUTE AND COMMISSION

In response to both the continuing appellate challenges contending that the Administration was denying benefits by improperly requiring objective evidence of the severity of pain and the fear of some congressmen that the court decisions were giving too much weight to subjective complaints,<sup>19</sup> the Ninety-eighth Congress enacted Section 3 of the Social Security Disability Benefits Reform Act of 1984. The Act amended 42 U.S.C. section 423(d)(5)(A) by codifying the standard for the evaluation of claims of disabling pain already found in the Administration's regulations and rulings.<sup>20</sup> The true promise of the legislation, however,

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17. *Avery v. Secretary of Health & Human Serv.*, 797 F.2d 19 (1st Cir. 1986); *Turner v. Heckler*, 754 F.2d 326 (10th Cir. 1985); *Nieto v. Heckler*, 750 F.2d 59 (10th Cir. 1984); *Hillhouse v. Harris*, 715 F.2d 428 (8th Cir. 1983).

18. *Look v. Heckler*, 775 F.2d 192 (7th Cir. 1985); *Broadbent v. Harris*, 698 F.2d 407 (10th Cir. 1983).

19. REPORT OF THE COMMISSION ON THE EVALUATION OF PAIN, *supra* note 7, at xi.

20. 42 U.S.C. § 423(d)(5)(A) (Supp. IV 1986), as amended, states as follows: An individual shall not be considered to be under a disability unless he furnishes such medical and other evidence of the existence thereof as the Secretary may require. An individual's statement as to pain or other symptoms shall not alone be conclusive evidence of disability as defined in this section; there must be medical signs and findings, established by medically acceptable clinical or laboratory diagnostic techniques, which show the existence of a medical impairment

came in its requirement that the Secretary of Health and Human Services appoint a commission to study and evaluate pain, in consultation with the National Academy of Sciences, for the purpose of formulating recommendations on how subjective pain should be considered in the adjudication of disability benefits. Thus, the codified standard was given an expiration date of December 31, 1986, in anticipation of revisions based upon the Commission's recommendations.

On April 1, 1985, the Commission on the Evaluation of Pain ("Commission") was appointed. The Commission sent its report to the Secretary of Health and Human Services on June 29, 1986.

Unfortunately, the Commission's central conclusion was that further study was necessary. Accordingly, it proposed retention of the standard contained in 42 U.S.C. section 423(d)(5)(A) and requested a special study by the National Academy of Sciences.<sup>21</sup>

Despite the Commission's failure to formulate recommendations for revision of the Act or regulations, its findings validated the complexity of this legal-medical issue. The Commission noted that pain can be categorized as acute and chronic and stated further that "[t]he distinctions between the two are important for proper assessment of disability."<sup>22</sup> Acute pain is pain which is of a recent onset and will be of limited duration. The Commission found that pain of this nature "is dealt with relatively well under current law."<sup>23</sup> Chronic pain, on the other hand, is either constant, or intermittent over a long period of time, and persists after healing. The category of chronic pain also includes chronic pain syndrome. One of the initial findings of the Commission was that chronic pain and chronic pain syndrome, as opposed to acute pain, are inadequately understood by patients, professionals, and the Administration.<sup>24</sup>

The complex experience of chronic pain involves physical and mental processes which are necessarily affected by personal response and ad-

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that results from anatomical, physiological or psychological abnormalities which could reasonably be expected to produce the pain or other symptoms alleged and which, when considered with all evidence required to be furnished under this paragraph (including statements of the individual or his physician as to the intensity and persistence of such pain or other symptoms which may reasonably be accepted as consistent with the medical signs and findings), would lead to the conclusion that the individual is under a disability. Objective medical evidence of pain or other symptoms established by medically acceptable clinical or laboratory techniques (for example, deteriorating nerve or muscle tissue) must be considered in reaching a conclusion as to whether the individual is under a disability.

21. REPORT OF THE COMMISSION ON THE EVALUATION OF PAIN, *supra* note 7, at xix, xx.

22. *Id.* at xvii.

23. *Id.*

24. *Id.*



aptation. Thus, the degree of identifiable body damage and an individual's ability to deal effectively with pain are the chief predictors of the individual's potential for functioning and possible return to work. Chronic pain syndrome, as differentiated from chronic pain, additionally involves recognizable psychological and socio-economic components. Because of these characteristic psychological and sociological behavior patterns, trained clinicians can distinguish chronic pain syndrome from malingering and serious emotional disorders.<sup>25</sup> The importance of this finding is that it gives validity to the common sense notion that no two individuals will experience pain in the same way.

The second general finding of the Commission is that malingering is not a significant problem. Furthermore, it can be diagnosed by trained professionals, both medical and otherwise. The importance of this finding, as noted by the Commission, is that the Administration can give increased attention to subjective evidence of disabling pain without a significant concern that by doing so unworthy applicants will be awarded benefits.<sup>26</sup>

Among the more dubious findings of the Commission was that the statutory standard for the consideration of pain "promoted a uniformity of adjudication at all levels within the Social Security Administration and in the courts which did not previously exist."<sup>27</sup> Thus, it recommended retention of the standard past the "sunset" date in order that further evaluation of the standard could be made.<sup>28</sup>

As can be seen in the following discussion of the Tenth Circuit's decision in *Luna v. Bowen* and the Seventh Circuit's decisions in *Meredith v. Bowen*, *Veal v. Bowen*, and *Walker v. Bowen*, it appears that the Commission was overly optimistic in finding that uniformity now exists between the circuit courts of appeals since the codification of the Administration's standard for evaluation of pain.

#### IV. *LUNA V. BOWEN*: THE TENTH CIRCUIT'S THREE-STEP ANALYSIS

At the time of the enactment of DRA, *Luna v. Bowen*, a class action, was pending in the District Court of Colorado.<sup>29</sup> The plaintiffs, all claimants for disability benefits under the Act, alleged that their claims had been improperly adjudicated due to vague policies of the Secretary regarding the evaluation of pain which were inconsistent with the DRA.<sup>30</sup> The district court, finding that the Secretary wrongly required

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25. *Id.*

26. *Id.* at xviii.

27. *Id.* at xix.

28. *Id.*

29. 641 F. Supp. 1109 (D. Colo. 1986).

30. *Id.* at 1113.

primarily objective medical evidence to substantiate allegations of the severity of pain, granted summary judgment to the plaintiffs, and the Secretary appealed.

On appeal to the Tenth Circuit, the court reversed the district court's decision because of its flawed analysis of "objective" medical evidence. The district court made two findings based upon this analysis.<sup>31</sup> First, it held that "the Secretary's regulations [were] facially invalid because they require a claimant to show objective medical evidence of a pain-producing impairment."<sup>32</sup> However, the Tenth Circuit determined that this finding was based on the erroneous premise that "objective evidence is limited to concrete physiological data,"<sup>33</sup> and, further, that purely psychological impairments were incapable of being proven by objective medical evidence. On appeal, the court relied on language in a case previously decided by the Tenth Circuit<sup>34</sup> to conclude that "objective medical evidence can be both physiological, psychological, or both."<sup>35</sup> Accordingly, this portion of the district court's holding was reversed outright.<sup>36</sup> The second part of the district court's decision presented a greater problem for the court of appeals. The district court's second holding was that the Secretary, after finding the pain-producing impairment, improperly relied primarily on objective medical evidence to determine the disabling effect of pain, *i.e.*, to determine the severity of pain.<sup>37</sup> Although the Tenth Circuit was unable to determine the extent to which the district court's holding was affected by its flawed analysis of what constitutes objective medical evidence, it considered the issue in order to provide a proper framework for the case on remand.<sup>38</sup>

Finding that neither the Act, as amended, the regulations, or other agency rulings and instructions clearly described how much weight a decisionmaker must give to subjective allegations of pain, the court noted:

We have recognized the statute requires that a pain-producing impairment, whether psychological or physiological in origin, must be proven by objective medical evidence before an agency decision maker can find a claimant disabled by pain. . . . The issue in this case, however, is what the decision maker must do after finding that a pain-producing impairment exists.<sup>39</sup>

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31. *Luna v. Bowen*, 834 F.2d 161, 163 (10th Cir. 1987).

32. *Id.* at 162.

33. *Id.*

34. *Teter v. Heckler*, 775 F.2d 1104 (10th Cir. 1985).

35. *Luna*, 834 F.2d at 162.

36. *Id.*

37. *Id.*

38. *Id.* at 163-66.

39. *Id.* at 163 (citations omitted).



To answer this issue, the court adopted the Secretary's description of the three-step analysis to be employed by the decisionmaker after finding the existence of a pain-producing impairment. First, the claimant must demonstrate by objective medical evidence that a pain-producing impairment exists before the decisionmaker may consider the relationship between the impairment and the pain alleged.<sup>40</sup> Thus, the second step requires that the decisionmaker take "the [claimant's] subjective allegations of pain as true in determining whether they are *reasonably* related to the proven impairment."<sup>41</sup>

It is at this second stage that the problem arises and presents itself for resolution by the court: what nexus between the established impairment and alleged pain is required? The court noted that both parties failed to address what "standard of reasonableness . . . the Secretary must use to determine whether the impairment is one that could 'reasonably' be expected to produce the alleged disabling pain."<sup>42</sup> Finding that sufficient evidence of congressional intent existed to convince the court that the statute required only a loose connection between the proven impairment and the alleged pain, it held that, "if an impairment is reasonably expected to produce *some* pain, allegations of *disabling* pain emanating from that impairment are sufficiently consistent to require consideration of all relevant evidence."<sup>43</sup> In other words, proof of an impairment that could be expected to cause pain in the lower extremities would not reasonably be expected to produce disabling pain in the upper body. However, an impairment likely to produce *some* pain in a particular area of the body may be reasonably expected to produce disabling pain in a particular claimant because, according to the court, Congress recognized that two patients with the same impairment may be affected with radically different pain.<sup>44</sup> Thus, once the nexus is established,

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40. *Id.* "The term 'objective' in this context refers . . . to any evidence that an examining doctor can discover and substantiate." *Id.* at 162.

41. *Id.* at 163 (emphasis added). The Secretary also stated that the role of the decisionmaker was not to evaluate the claimant's credibility. *Id.*

42. *Id.*

43. *Id.* at 164 (emphasis in original).

44. *Id.* at 164-65. In this regard, the court noted that:

In amending section 423 and codifying an objective evidence requirement, Congress certainly intended to help alleviate the tremendous administrative burden borne by the social security system in determining who is in fact disabled by pain. Because one cannot conclusively prove the severity of an individual's pain through medical test results, however, Congress stopped short of requiring medical evidence of severity. Rather, the decision maker must consider all the evidence presented that could reasonably produce the pain alleged once a claimant demonstrates a pain-causing impairment. Clearly, Congress believed that this scheme would reduce the administrative burden without permitting the Secretary to deny

“the absence of an objective medical basis for the degree of severity of pain may affect the weight to be given to the claimant’s subjective allegations of pain, but a lack of objective corroboration of the pain’s severity cannot justify disregarding those allegations.”<sup>45</sup>

The court defended its analysis by reasoning that, if objective medical evidence was required to establish the severity of pain, subjective testimony would serve no purpose at all. Such a construction would be contrary to the statute’s mandate requiring consideration of all evidence of pain, including statements of the individual or his physician about the intensity and persistence of pain.<sup>46</sup>

Once the first two steps are established, namely objective evidence of an abnormality that could reasonably be expected to cause some of the pain complained of, then the decisionmaker is required to consider all evidence of pain to determine its disabling effect. It is at this third step that subjective statements of the claimant, or other witnesses, and opinions of his physician regarding the intensity, persistence and disabling effects of the pain are to be considered.<sup>47</sup>

The court anticipated criticism that its approach would force decisionmakers to decide cases based solely upon their evaluation of the credibility of subjective statements of the claimant or the opinions of his physicians. The court noted that, although it is impossible to know how pain affects any particular individual, a variety of indicators exist that provide insight into how much pain a person is experiencing and assist in determining whether descriptions of the claimant’s pain were consistent with known pain-related behaviors. The court cited, for example, that persistent attempts to find relief for pain, which would be reflected in medical records; willingness to try any prescribed treatment, also reflected in the medical records; regular use of crutches or a cane, which is observable; regular contact with a doctor, which, again, is verifiable by medical records; limitation of daily activities; and, frequent use of pain medications, are all behaviors that the decisionmaker can consider, among many others, in evaluating a claimant’s allegations of disabling pain.<sup>48</sup>

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benefits automatically to those with objectively proven impairments that usually (but not invariably) cause only non-disabling pain.

*Id.* at 165.

45. *Id.* (emphasis omitted) (quoting *Polaski v. Heckler*, 751 F.2d 943, 948 (8th Cir. 1984)).

46. *Luna*, 834 F.2d at 165.

47. *Id.*

48. *Id.* at 165-66.



## V. THE SEVENTH CIRCUIT'S APPROACH TO PAIN EVALUATION

The Tenth Circuit's decision in *Luna v. Bowen* contrasts markedly with the Seventh Circuit's approach to pain evaluation as demonstrated by its decisions in *Meredith v. Bowen*, *Veal v. Bowen*, and *Walker v. Bowen*. Whereas *Luna* required only a "loose nexus" between the pain-causing impairment and the alleged pain before requiring the decision-maker to proceed to consider subjective evidence and opinion regarding pain, the Seventh Circuit's opinions can be read to permit the Secretary to emphasize corroboration of the alleged severity of pain by objective medical evidence.

### A. Meredith v. Bowen

*Meredith v. Bowen*,<sup>49</sup> decided December 9, 1987, involved the Secretary's appeal of a decision from the Southern District of Indiana reversing the decision of an administrative law judge ("ALJ") and awarding disability benefits to the claimant.

The evidence revealed that Sue Meredith's legs and pelvis were fractured, and her spine was injured in an automobile accident in 1967. She was hospitalized at the time of the injury for seven weeks and again about one year later when she required a spinal fusion. Two years after the accident, Meredith applied for and was awarded a "closed" period of disability from the date of her accident until February, 1970. She did not pursue an appeal of the determination not to award her continuing benefits.<sup>50</sup>

From 1970 until 1973, Meredith was treated by several physicians for neck and shoulder pain in addition to other maladies. From examinations of Meredith during this period, physicians noted that she had a reduced range of motion in her neck. One physician believed that X-rays of the spinal fusion showed "evidence of a compression fracture of the fused vertebrae and possible motion between the fused vertebrae."<sup>51</sup> A neurosurgeon noted Meredith's complaints of pain and dizziness and found that she had severe congenital or post-traumatic changes in the cervical spine which he believed accounted for her symptoms. Meredith was hospitalized one time during this period and was diagnosed as having minimal osteoarthritis in her spine. Meredith made a second disability benefits application in November, 1973. This application was denied in January, 1974 because she had failed to prove that she was disabled on or before December 31, 1972, which was the date her insured status

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49. 833 F.2d 650 (7th Cir. 1987).

50. *Id.* at 651.

51. *Id.*

expired. This failure of proof was compounded by the fact that "Meredith had worked eight to nine hours a day as a tomato peeler during the harvest season of 1973."<sup>52</sup> Meredith did not request a reconsideration of this decision.

In January, 1984, Meredith filed her third disability benefits application. At that time she indicated she had been unable to work since February, 1970. In considering this third application, the ALJ "discovered that the SSA had miscalculated the expiration of Meredith's insured status . . . [which] actually expired on March 31, 1973."<sup>53</sup> Her second application was reopened for a determination of disability during the last quarter of her insured status. Her eligibility for disability benefits expired on March 31, 1973, and she did not work between then and her last application for disability benefits in January, 1984.

Prior to the hearing on her application for disability benefits, she was examined by two physicians who concluded that she was totally disabled as of that time. The issue, however, before the ALJ was whether Meredith was disabled on or before March 31, 1973. At the hearing before the ALJ, "Meredith testified that she suffered from pain, dizziness and problems with the strength of her grip since 1972 due to numbness in her arms and hands and that her problems had gotten progressively worse."<sup>54</sup> Standing was a problem for her because of her knees, and sitting was a problem because she experienced severe headaches if she sat too long.<sup>55</sup>

Even though the ALJ found that Meredith had a severe impairment, that her testimony regarding pain was credible and that she could not perform her past work, he found that she could have done other jobs during the relevant period on the basis of testimony by a vocational expert. Thus, he denied her application for disability benefits.<sup>56</sup> The district court found that the ALJ effectively ignored the objective medical evidence of Meredith's pain, failed to give the proper consideration to Meredith's complaints of pain and failed to have the vocational expert consider the effect of Meredith's alleged pain on her ability to do the other jobs he identified.<sup>57</sup> The district court found that, since Meredith's statements regarding pain were credible and supported by objective medical evidence, the pain statute (42 U.S.C. section 423(d)(5)(A)) required a finding of disability.<sup>58</sup> The Seventh Circuit reversed holding that the

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52. *Id.* at 652.

53. *Id.*

54. *Id.* at 653.

55. *Id.*

56. *Id.*

57. *Id.* at 653.

58. *Id.* at 654.



district court's finding amounted to nothing more than substituting its judgment for that of the ALJ.<sup>59</sup>

From the Seventh Circuit's decision, it appears that the district court used an approach similar to the three-step test in *Luna*. Having found, in effect, that all three parts of the test had been met, the district court's decision necessarily required reversal of the Secretary's determination. In reversing the district court's decision, the court stated that it was not necessary to look beyond the words of the pain statute because it was clear and unambiguous. It then engaged in a curious analysis of that statute: "objective medical evidence of pain must be considered by an ALJ in determining whether an individual is disabled. Such evidence does not, however, mandate a finding of disability."<sup>60</sup>

Up to that point, the court's analysis would have been consistent with *Luna* (and the district court) because the objective medical evidence clearly established that Meredith had an impairment and there was some medical evidence to substantiate Meredith's claim that the particular impairment caused pain. Thus, under *Luna*, the ALJ would have had to consider all other evidence of pain including Meredith's testimony of her symptoms. Because the ALJ found Meredith's symptoms credible, it appears that the *Luna* analysis, like that of the district court, would have mandated a finding of disability. But the Seventh Circuit intercepted the progression of the analysis from the second step to the third.

What the Seventh Circuit did was find that some medical records, those closest in time to Meredith's last date of entitlement, did not support her claim of disabling pain.<sup>61</sup> In other words, the court found that there was insufficient objective medical evidence to support Meredith's claims of disabling pain even though the ALJ found Meredith's testimony to be credible.

If it is not clear from *Meredith* that the Seventh Circuit will allow the Secretary to emphasize the need for objective medical evidence to corroborate the severity of pain, it is clear from the Seventh Circuit's other decisions in *Veal v. Bowen*<sup>62</sup> and *Walker v. Bowen*<sup>63</sup>.

### B. *Veal v. Bowen*

*Veal* involved an appeal from the district court which affirmed the Secretary's decision denying Lillie Veal's application for disability benefits. The Seventh Circuit Court of Appeals affirmed.<sup>64</sup>

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59. *Id.*

60. *Id.*

61. *Id.* at 655.

62. 833 F.2d 693 (7th Cir. 1987).

63. 834 F.2d 635 (7th Cir. 1987).

64. 833 F.2d at 694.

Veal complained that she was disabled by a number of ailments including high blood pressure, arthritis in her right hand, headaches, dizziness, back pain and others. To substantiate her ailments, Veal relied upon the reports of her treating physician. Comparing Veal's subjective complaints with the medical evidence provided by a consulting physician and Veal's treating physician the ALJ determined that "the diagnoses of [Veal's treating physician] was inconsistent with other objective medical findings and . . . in light of the contrary medical evidence, the subjective symptoms of Ms. Veal were not credible."<sup>65</sup> The ALJ relied upon the consulting physician's examination and report to conclude that Ms. Veal's physical impairments did not preclude her from returning to her past occupation.<sup>66</sup>

In its review of the record, the court found substantial evidence to support the ALJ's findings, specifically that "objective medical evidence did not corroborate Ms. Veal's contentions that she was unable to perform her past work."<sup>67</sup> Indeed, it appears from the court's decision that the reports of Veal's treating physician did not specify any of the bases upon which he rendered his diagnosis of Veal's complaints.<sup>68</sup>

What is important, however, about the court's decision in *Veal* is its attempt to formulate an approach to the evaluation of subjective complaints:

Despite a paucity of objective medical evidence directly supporting a disability, the claimant may prove that she is "disabled" within the SSA by subjective complaints if she shows: 1) evidence of an objectively adduced abnormality *and, either* 2) objective medical evidence supporting the subjective complaints issuing from that abnormality, *or* 3) that the abnormality is of a nature in which it is reasonable to conclude that the subjective complaints are a result of that condition.<sup>69</sup>

This two-step approach appears to allow the analysis of a subjective complaint such as pain to stop at step two if objective medical evidence supports the subjective complaints issuing from that abnormality. If this is so, it appears to contradict the court's decision rendered five days

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65. *Id.* at 695-96.

66. *Id.* at 694-96. Ms. Veal's most recent employment was in the capacity of a home health care worker in which she assisted homebound individuals with meal preparation, bathing, laundry, cleaning, etc. *Id.* at 694.

67. *Id.* at 698.

68. *Id.* at 695-96.

69. *Id.* at 698 (emphasis in original) (citing *Sparks v. Bowen*, 807 F.2d 616, 618 (7th Cir. 1986)).



earlier in *Meredith* in which the Seventh Circuit held: "[Objective medical evidence of pain] does not, however, mandate a finding of disability."<sup>70</sup> If it was not the court's intent to permit the inquiry to end with objective medical evidence supporting a subjective complaint, why would it offer the alternative step three, permitting an inquiry into whether the abnormality is of a nature in which it is reasonable to conclude that the subjective complaints are a result of the condition?

The approach in *Veal* leaves important questions unanswered. For example, if equally weighted objective medical evidence regarding the subjective complaints was conflicting, could the conflict form the basis for rejecting otherwise credible testimony of the claimant? In other words, if *Veal*'s treating physician had been a specialist and had identified the bases of his diagnosis in order to substantiate his opinion, could credible testimony by *Veal* of subjective complaints be rejected on the basis that another specialist's opinion contradicted that of her treating specialist? Under a *Luna* analysis, it would appear incorrect to disregard credible testimony and opinions regarding the existence of disabling pain because a connection existed between the objectively proven impairment and some pain which can be reasonably expected to result from it. Had the facts in *Veal* been like those in the foregoing hypothetical question, would the result suggested by *Luna* be possible in light of the court's earlier decision in *Meredith*? It appears that the answer would be negative.

### C. Walker v. Bowen

The court's final decision during the survey period in *Walker v. Bowen*<sup>71</sup> would seem to close the door on the *Luna* result. In *Walker v. Bowen*, the claimant, Benny Walker, injured his back in October 1980. He went to a neurosurgeon who diagnosed Walker as suffering from a left lumbar disc protrusion. Walker's injury did not improve with conservative treatment, so the neurosurgeon performed a discectomy in March 1981, approximately six months after the injury. Three months later, a second discectomy was performed. As Walker recuperated, the back condition began to improve. Six months later, the neurosurgeon informed the Disability Determination Division of his opinion that Walker would be able to return to work in February 1982 and further that Walker was medically unfit for work from the time of the injury in October 1980 through February 1982.<sup>72</sup>

Walker was awarded a closed period of disability from October 1980 through December 1981, based upon a medical examination in December

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70. *Meredith v. Bowen*, 833 F.2d 650, 654 (7th Cir. 1987).

71. 834 F.2d 635 (7th Cir. 1987).

72. *Id.* at 636-37.

1981 concluding that he was fit. Walker did not seek review of the denial of continuing benefits.<sup>73</sup>

Unfortunately for Walker, however, he began to experience back problems again in January 1982. At that time, he was admitted to the hospital where no new damage to the back was discovered. He was released but readmitted again in March 1982. He made some improvement and his neurosurgeon rendered an opinion that he would be able to return to work in June 1982. In May 1982, another doctor examined Walker at the request of the Secretary. Like Walker's treating physician, the consulting doctor found Walker to be partially impaired and noted that he was taking pain medication containing a narcotic. Walker did not return to work. For the next five months, Walker received physical therapy. The therapist's notes indicated that Walker experienced some pain during therapy. When Walker failed to improve with physical therapy, his neurosurgeon operated on him in January 1983, the third time in less than two years. By July 1983, Walker's back condition apparently stabilized. In July and August, consulting physicians concluded that Walker could do sedentary work.<sup>74</sup>

In November 1983, a hearing was held to review Walker's disability claim.<sup>75</sup> At that time, Walker testified that he took considerable amounts of pain medication and wore an electronic nerve stimulator to control his pain. He introduced evidenced that he attended a vocational evaluation program and that a vocational rehabilitation worker had concluded that he was physically unfit to undergo training even for sedentary work because of severe pain.<sup>76</sup>

Although the ALJ found that Walker suffered from a severe back impairment, he found that Walker had not proven he was totally disabled for a continuous 12-month period and that Walker had the physical ability to pursue sedentary work.<sup>77</sup> Relying on the Medical Vocational Guidelines which considered factors such as Walker's relatively young age and prior work experience, the ALJ found that Walker was not disabled.<sup>78</sup>

Walker appealed this decision to the district court. That court reversed the Secretary's decision with respect to the first part of the period in dispute and awarded Walker disability benefits for the period from

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73. *Id.* at 637.

74. *Id.* at 636-38.

75. *Id.* at 639. Walker had previously filed applications for disability benefits (for the post-December 1981 period) in January and February 1983, and both the original application and reconsideration had been denied. *Id.*

76. *Id.* at 638.

77. *Id.* at 639.

78. *Id.*



December 1981 through July 1983. In the second part of its decision, the district court upheld the denial of benefits for the period of time after July 1983.<sup>79</sup>

Walker appealed the district court's decision to the Seventh Circuit and the Secretary cross-appealed. The Seventh Circuit reversed that portion of the judgment which granted Walker benefits and affirmed that part of the district court's judgment which approved the denial of benefits to Walker for the period after July 1983.<sup>80</sup>

On appeal, Walker alleged a number of errors, including a contention that "the ALJ applied the wrong legal standard by discounting his testimony regarding pain solely because it was not totally supported by objective medical evidence."<sup>81</sup> The court, however, concluded that the ALJ discounted Walker's complaints on a finding that Walker's account of his pain was not credible because his descriptions of the pain during his testimony were inconsistent. Because credibility determinations are traditionally reserved for the trier of fact, the court declined to substitute its opinion for the credibility determination made by the ALJ.<sup>82</sup>

The court reiterated the congressional determination found in the pain statute that an individual's statement as to pain or other symptoms alone is not conclusive evidence of disability and that medical signs and findings which could reasonably be expected to produce the pain must be shown. Following this statement, the court noted: "Furthermore, we concluded in *Nelson*,<sup>83</sup> 770 F.2d [682,] 685, that a claim of pain may be discounted if it is not borne out by objective medical evidence."<sup>84</sup>

This statement seems to put the Seventh Circuit squarely at odds with the Tenth Circuit. Under *Luna*, some objective evidence of pain caused by the proven impairment would seem to require basing the ultimate determination on the credibility of the claimant's statements and the opinions of his physicians regarding pain. The foregoing quote from *Walker*, on the other hand, seems to imply that regardless of the credibility of the claimant's testimony and his physician's opinion, they can be rejected if the objective medical evidence isn't sufficient in the eyes of the decisionmaker.

Based on the foregoing analysis of *Luna*, *Meredith*, *Veal* and *Walker*, it appears that there will continue to be a considerable difference in approach between at least two circuits in the evaluation of pain. It is

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79. *Id.*

80. *Id.* at 644-45.

81. *Id.* at 641.

82. *Id.*

83. *Nelson v. Secretary of Health & Human Serv.*, 770 F.2d 682, 685 (7th Cir. 1985).

84. *Id.*

not unreasonable to conclude that a claimant's statements and his physician's opinions will be given more weight in the Tenth Circuit whereas the Seventh Circuit will permit the Secretary to emphasize the need for corroboration of subjective complaints of pain by objective medical evidence.

## VI. CONCLUSION

Until further study of pain results in a more definitive approach to its evaluation in disability cases, it appears that the social security disability practitioner residing in the Seventh Circuit must carefully evaluate a claimant's allegations of disabling pain and meticulously gather objective medical evidence establishing abnormalities; then, with the aid of medical treatises and opinions, draw a connection between the abnormality and the pain alleged. The presentation of considerable testimony from the claimant and others who know him, as well as the opinions of his physicians concerning pain, should be used to bolster conflicting or scant medical findings. With regard to the latter, it is important for the practitioner to accumulate as much evidence as possible of behavioral manifestations of pain. In addition to those suggested by *Luna*, it would be advisable to obtain and present evidence demonstrating consistent audible and/or body language displays of pain during activity such as groaning, grimacing, bracing, guarded movements or disturbances of posture or gait. These observations can come from physicians or their reports, family members or neighbors. In addition, testimony concerning the avoidance of activities that are normally pleasurable such as socializing and sexual relationships, can demonstrate the claimant's desire to protect himself from pain aggravating activity. The practitioner can also find assistance in the development of pain fact proofs by reviewing the sample pain questions for physicians, claimants and the claimant's relatives or friends found in Appendix E of the *Report of the Commission on the Evaluation of Pain*.<sup>85</sup>

Until a truly uniform approach to evaluation of pain in Social Security disability cases is made part of the law, the Administration and some courts will remain apprehensive about granting appropriate emphasis to subjective accounts of disability symptomology, even though malin-gering is not a substantial problem.

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85. REPORT OF THE COMMISSION ON THE EVALUATION OF PAIN, *supra* note 7, at 169-72.





# Selected Current Topics in Indiana Taxation

FRANCINA A. DLOUHY\*

## I. INTRODUCTION

This Article addresses several current topics in Indiana taxation. First, it will review recent developments in the treatment of partnerships and joint ventures for Indiana income tax purposes. For over 25 years, Indiana has wrestled with the issue of how partnerships and joint ventures should be taxed, changing course several times during those years. Many new and significant commercial operations in the state today are joint ventures or partnerships and it is imperative that Indiana have a clear and, more importantly, a stable position on the taxation of these business forms.

Next, the Article will review recent case law developments in the area of Indiana's personal property tax, particularly those decisions addressing the interstate commerce or warehouse exemptions for finished goods inventory. These exemptions have provided significant property tax relief to Indiana taxpayers over the years, and in three recent decisions the Indiana Tax Court has provided guidance on such issues as *who* is entitled to claim these exemptions,<sup>1</sup> *when* those exemptions are waived by the taxpayer<sup>2</sup> and *how many* exemptions a taxpayer may claim.<sup>3</sup> During the survey period, the tax court also addressed the heretofore controversial issue of whether a taxpayer is entitled to an inventory valuation adjustment for changes in the inventory's market value, and the court's decision on this issue in *Don Meadows Motors, Inc. v. State Board of Tax Commissioners*<sup>4</sup> will be reviewed.

The Indiana Tax Court's decision in *West Publishing Co. v. Indiana Department of Revenue*,<sup>5</sup> an important case during the survey period which further develops Indiana law on what constitutes "solicitation" pursuant to Public Law No. 86-272,<sup>6</sup> will be discussed. Congress provided

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\* Partner, Baker & Daniels, Indianapolis. B.A., Hiram College, 1974; J.D., Indiana University School of Law, 1977.

1. *State Line Elevator, Inc. v. State Bd. of Tax Comm'rs*, 528 N.E.2d 501 (Ind. T.C. 1988).

2. *Gulf Stream Coach, Inc. v. State Bd. of Tax Comm'rs*, 519 N.E.2d 238 (Ind. T.C. 1988).

3. *RCA Corp. v. State Bd. of Tax Comm'rs*, 528 N.E.2d 125 (Ind. T.C. 1988).

4. 518 N.E.2d 507 (Ind. T.C. 1988).

5. 524 N.E.2d 1329 (Ind. T.C. 1988).

6. Act approved Sept. 14, 1959, Pub. L. No. 86-272, 73 Stat. 555 (codified as amended at 15 U.S.C. §§ 381-84 (1982)). In this Act, Congress "exercised its power to regulate state taxation of activities related to interstate commerce." 524 N.E.2d at 1335.



in this federal legislation that a state may not subject a nonresident taxpayer to net income tax if that nonresident's activities in the state do not exceed the solicitation of orders for goods.<sup>7</sup> The *West Publishing* decision not only reaffirms that Indiana interprets the term "solicitation" to include all of those activities inextricably related to solicitation, but also establishes that acts of courtesy and services rendered to a customer to facilitate a sale may be protected activities under the federal law. *West Publishing* clearly aligns Indiana with those states that have refused to adopt an unduly narrow and technical interpretation of the term "solicitation," instead applying that term in its ordinary and reasonable commercial sense.

On the administrative front, the Indiana General Assembly has given taxpayers some degree of assurance that there will be consistency in the administration and application of Indiana's tax laws. This Article will review Indiana Code section 6-8.1-3-3, which prohibits the Indiana Department of Revenue ("Department" or "Revenue" Department) from changing its interpretation of a tax law in such a way that the taxpayer's liability is increased, unless that change in interpretation is prospective in operation and effectuated by the formal *promulgation of a regulation*.<sup>8</sup> Clearly a legislative reaction to the Revenue Department's repeated "flip-flopping" on significant tax issues, this somewhat novel statute may provide taxpayers with some assurance of consistency in the application of Indiana's tax laws, that in turn will facilitate business and tax planning.

Finally, in light of the recent case of *Blood v. Poindexter*,<sup>9</sup> this Article will re-examine the issue of the Indiana Tax Court's jurisdiction.<sup>10</sup> During the survey period, the Indiana Tax Court once again faced a challenge to its jurisdiction, specifically, whether that court has exclusive jurisdiction over inheritance tax matters.<sup>11</sup> In *Blood*, as in previous cases challenging the jurisdiction of the Indiana Tax Court,<sup>12</sup> Judge Fisher reiterated the tax court's position that in creating the Indiana Tax Court the legislature's intent was to consolidate *all* tax issues in one judicial forum and held that the tax court has exclusive jurisdiction over inheritance tax appeals from final determinations of the Indiana Department of Revenue.<sup>13</sup>

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7. 15 U.S.C. § 381 (1982).

8. IND. CODE § 6-8.1-3-3 (1988).

9. 524 N.E.2d 824 (Ind. T.C. 1988).

10. This issue was previously addressed in F. Dlouhy & J. King, *Significant Developments in Indiana Taxation*, 21 IND. L. REV. 383 (1987).

11. *Blood*, 524 N.E.2d at 824.

12. See, e.g., *Herff Jones, Inc. v. State Bd. of Tax Comm'rs*, 512 N.E.2d 485 (Ind. T.C. 1987) (Indiana Tax Court has "exclusive jurisdiction in refund case in which county board of commissioners had no discretion to allow refund claim following State Board's disapproval of claim.").

13. 524 N.E.2d at 825.

## II. THE TAXATION OF PARTNERSHIPS IN INDIANA

During the survey period, the number of major operations doing business in Indiana as corporate joint ventures or partnerships has significantly increased. An advantage of doing business as a partnership or a joint venture in Indiana is the exemption from gross income tax granted by Indiana Code section 6-2.1-3-25(b).<sup>14</sup> In 1988, the legislature re-examined this exemption, but only placed a minor limitation on its availability.<sup>15</sup> This exemption should thus be considered in weighing the pros and cons of doing business in Indiana as a partnership vis-a-vis a corporation.

All partnerships today are exempted from Indiana gross income tax,<sup>16</sup> adjusted gross income tax<sup>17</sup> and supplemental net income tax.<sup>18</sup> This includes corporate partnerships, (partnerships with one or more corporate partners) and two-tier partnerships (partnerships where the first-tier partners are themselves partnerships).

This was not always the case, however. Indiana has vacillated numerous times on how partnerships should be taxed. Prior to the enactment of the Adjusted Gross Income Tax Act<sup>19</sup> in 1963, Indiana had only one income tax, the gross income tax,<sup>20</sup> that was imposed upon partnerships, joint ventures and pools.<sup>21</sup> If the gross income tax was paid on the gross income of the partnership, joint venture or pool, the amounts received by the partners or participants as their respective distributive shares of the income of the partnership, joint venture or pool, were exempted from gross income tax.<sup>22</sup> In short, prior to the enactment of the Adjusted Gross Income Tax Act, partnerships or joint ventures were treated as separate taxable entities subject to the Indiana gross income tax.

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14. IND. CODE § 6-2.1-3-25(b) (1988). This section provides:

Gross income received by a partnership is exempt from gross income tax. However, a gross income is not exempt from the gross income tax if it is received by a publicly traded partnership that is treated as a corporation for federal income tax purposes under section 7704 of the Internal Revenue Code.

15. In the 1988 amendment, the legislature added the second sentence to subsection (b).

16. IND. CODE § 6-2.1-3-25(b) (1988).

17. *Id.* § 6-3-4-11.

18. *Id.* § 6-3-8-5.

19. Adjusted Gross Income Tax Act of 1963, ch. 32 (Spec. Sess.), 1963 Ind. Acts (Spec. Sess.) 82.

20. IND. CODE ANN. §§ 64-2601 to 31 (Burns 1961) (current version at IND. CODE §§ 6-2.1-1-1 to § 6-2.5-10-4 (1988)).

21. IND. CODE ANN. § 64-2601(a) (Burns 1961) (current version at IND. CODE § 6-2.1-1-16 (1988)).

22. IND. CODE ANN. § 64-2607(a) (Burns 1961) (current version at IND. CODE § 6-2.1-3-25 (1988)).



In 1963, the Indiana General Assembly enacted the Adjusted Gross Income Tax Act, drafting the legislation so that it piggy-backed on the federal income tax framework.<sup>23</sup> As a result, the legislature effectively exempted partnerships from the adjusted gross income tax, instead imposing that tax on the partners and the partners' net distributive share of partnership income. Two years later, the legislature exempted partnerships from the gross income tax,<sup>24</sup> making such exemption retroactive to June 30, 1963, the effective date of the Adjusted Gross Income Tax Act. Thus, in the early 1960's, for purposes of both of Indiana's income taxes, partnerships were not treated as separate taxable entities, but instead as pass-through entities, with the tax liability being imposed upon the partners or participants.

The enactment of this exemption for partnerships and joint ventures prompted many corporations to join in a partnership with another corporation, individual or partnership. For six years, many Indiana businesses did business as partnerships or joint ventures. Then, in 1969, perhaps prompted by a short fall in revenues, the legislature created the Indiana tax concept of "corporate partnerships" as constituting separate taxable entities.<sup>25</sup> The Adjusted Gross Income Tax Act was again amended to add a new subsection that provided as follows:

(b) Every partnership, of which one or more of the partners is a corporation, shall be liable for the tax on gross income imposed by sections 2 and 3 of the Gross Income Tax Act of 1933, as amended. When such a partnership is liable for tax on its gross income, no partner shall be liable for the tax imposed on the partner's distributive share of the partnership income by this Act. Nor shall any partner in such a partnership be liable for the tax imposed on the partner's distributive share of partnership income by the Gross Income Tax Act of 1933, as amended.<sup>26</sup>

Under this amendment, the Indiana gross income tax was imposed on corporate partnerships as separate taxable entities, and the partners of such corporate partnerships were expressly exempted from liability for both the adjusted gross income tax and gross income tax in respect to their distributive shares. However, since the adjusted gross income tax itself was still piggy-backed on the federal income tax framework, the net effect of exempting the partners of a corporate partnership from

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23. Adjusted Gross Income Tax Act of 1963, ch. 32 (Spec. Sess.), 1963 Ind. Acts (Spec. Sess.) 82.

24. Act approved March 10, 1965, ch. 233, § 28, 1965 Ind. Acts 582, 603 (amending the Adjusted Gross Income Tax Act).

25. Act approved March 14, 1969, ch. 326, § 12, 1969 Ind. Acts 1372, 1390.

26. *Id.*

this particular tax liability was to render no one liable for adjusted gross income tax on the net income of a corporate partnership. In short, under the federal tax structure, the corporate partnership was not a taxpayer and, under Indiana's 1969 amendment, the partners of a corporate partnership were not subject to adjusted gross income tax liability. Simply stated, no one was technically subject to adjusted gross income tax attributable to corporate partnership income.

In 1971, additional amendments to the Adjusted Gross Income Tax Act<sup>27</sup> provided that corporate partnerships, as separate taxable entities, would be subject to both gross income and adjusted gross income taxes.<sup>28</sup> The amendments also reaffirmed that the partners of a corporate partnership would not be liable for gross income or adjusted gross income taxes on the partner's distributive share of income from the corporate partnership.<sup>29</sup>

To circumvent the amendment's effective elimination of the gross income tax exemptions for corporate partnerships, many corporate partnerships simply reorganized into two-tier partnerships where the first-tier partners were themselves partnerships, composed of corporate partners. As previously noted, the legislature had defined a corporate partnership as a partnership in which one or more of the partners is a corporation.<sup>30</sup> The argument put forth by the two-tier partnership was that none of its partners (*i.e.*, the first-tier partners) were corporations and, therefore, the 1969 and 1971 amendments were not applicable to it.<sup>31</sup> However, in the 1981 case of *Park 100 Development Company v. Indiana Department of State Revenue*,<sup>32</sup> the Indiana Supreme Court held that such two-tier partnerships could not be used to circumvent the tax.<sup>33</sup> The court thereupon pierced the partnership's veil, finding that it was only an attempt to cloak two corporations, which the court held were properly liable for gross income tax.<sup>34</sup>

Two years after the *Park 100* decision, the legislature amended the gross income tax and adjusted gross income tax laws again by eliminating the concept of a corporate partnership, treating all partnerships alike *and* exempting all partnerships from both the adjusted gross income and

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27. Act approved [April] 16, 1971, Pub. L. No. 64, 1971 Ind. Acts 311.

28. *Id.* § 7, 1971 Ind. Acts at 327.

29. *Id.*

30. See *supra* text accompanying notes 25-26.

31. See *Park 100 Dev. Co. v. Indiana Dep't of State Revenue*, 388 N.E.2d 293 (Ind. Ct. App. 1979), *rev'd*, 429 N.E.2d 220 (Ind. 1981).

32. 429 N.E.2d 220 (Ind. 1981).

33. *Id.* at 223.

34. *Id.*



gross income taxes.<sup>35</sup> Since 1983, the legislature has modified this exemption only once, to deny the exemption to partnerships that are treated as corporations under Internal Revenue Code section 7704.<sup>36</sup>

With partnerships reclassified as pass-through, nontaxable entities for income tax purposes, the question then became how their partners should be taxed. For adjusted gross income tax purposes, the answer was fairly clear. Because the adjusted gross income tax piggy-backs on the federal Internal Revenue Code,<sup>37</sup> the partner is liable on its net distributive share of partnership income as determined under that Code.<sup>38</sup>

For gross income tax purposes, the issue was more complicated. Many argued that the corporate partner's gross income tax liability should be based upon its pro rata share of the partnership's *receipts*. Others argued that the measure of the tax should be the amount *actually distributed* to the corporate partner. After much debate as to what should be the measure of the corporate partner's gross income tax liability, the Revenue Department adopted the position that a corporate partner shall only be subject to gross income tax on its *net* distributive share of partnership income.<sup>39</sup>

As the following two hypothetical situations illustrate, the Department's decision on how to tax corporate partners for gross income tax purposes can result in tax savings for a business that operates as a partnership, rather than a corporation. Assume that X Corporation and Y Corporation are partners of Z, an Indiana partnership. Z buys a widget for \$1,000. Z then sells that widget to a third party for \$1,000. As a result, Z recognizes no gain on the sale for federal income tax purposes, and (assuming that Z has no other income or loss for the relevant taxable year) X and Y will each report, for federal income tax purposes, \$0 of taxable income as their distributive shares of Z's taxable income for such year. In a second hypothetical assume the same set of facts, except that Z is an Indiana corporation. Because the Indiana Department of Revenue has concluded that the corporate partner's distributive share of partnership taxable income (per Federal Income Tax Schedule K-1) is subject to gross income tax, in the first hypothetical situation Z, the partnership, would have no gross income tax liability

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35. Act approved March 2, 1984, Pub. L. No. 47, 1984 Ind. Acts 617 (currently codified at IND. CODE § 6-2.1-3-25(b) (1988)).

36. Act approved March 5, 1988, Pub. L. No. 63, 1988 Ind. Acts 1144 (currently codified at IND. CODE § 6-2.1-3-25(b) (1988)).

37. See IND. CODE § 6-3-1-3.5 (1988).

38. See *id.* § 6-3-4-11.

39. Letter from Thomas A. Harling, Administrator of Income Tax Division, Indiana Department of Revenue to James L. Turner, Senior State Tax Consultant, Baker & Daniels (August 19, 1988).

pursuant to Indiana Code section 6-2.1-3-25. Since *X*'s and *Y*'s distributive shares of *Z*'s taxable income (for federal income tax purposes) are zero, *X* and *Y* will not have any gross income tax liability. In the second hypothetical situation *Z*, the corporation, will have gross income tax liability on the \$1,000 of gross receipts it received from the sale of the widget.

Contributions of capital to partnerships or joint ventures are exempt from gross income tax, and no gross receipts result to either the recipient of the capital or to the contributor.<sup>40</sup> Therefore, a partnership or joint venture can be established and assets transferred thereto without gross income tax consequences. It should be noted that the exemption provided by Indiana Code section 6-2.1-3-25(b) is not just available to partnerships engaged in ongoing businesses, but also is available to joint ventures taxpayers involved in one-time transactions or ventures, because technically the term "partnership" under the gross income tax act includes joint ventures.<sup>41</sup> According to the Indiana code:

The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation or venture is carried on, and which is not, within the meaning of this act, a corporation or a trust or an estate.<sup>42</sup>

This definition is exactly the same definition of a partnership as is set forth in the Internal Revenue Code.<sup>43</sup> As a result, whether an entity is a partnership for purposes of the Indiana exemption will turn in part upon whether the entity is considered to be a partnership under federal income tax standards.<sup>44</sup>

While operating as a partnership may in fact result in considerably less income tax liability, it should be observed that it may not always prove to be beneficial to operate as a partnership, vis-a-vis a corporation, because the Indiana Department of Revenue currently takes the position that partnership income is *always* taxable at the higher gross income tax rate. Thus, in the case of a *corporation* manufacturing and selling widgets, its gross receipts from the sale of widgets would be taxed at the lower gross income tax rate, currently .3%.<sup>45</sup> A *partnership* in the

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40. IND. CODE § 6-2.1-1-2(14) (1988).

41. *Id.* § 6-3-1-25 (partnership defined by reference to *id.* § 6-2.1-3-19).

42. *Id.* § 6-2.1-3-19.

43. I.R.C. §§ 761(a), 7701(a)(2) (1986).

44. See generally *Commissioner v. Tower*, 327 U.S. 280 (1946); *Commissioner v. Culbertson*, 337 U.S. 733 (1949); 1 W. McKEE, W. NELSON & R. WHITMIRE, *FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS* § 3 (1977); 1 A. WILLIS, J. PENNEL & P. POSTLEWAITE, *PARTNERSHIP TAXATION* § 2 (3d ed. 1988).

45. IND. CODE § 6-2.1-2-3(a) (1988).



exact same business would be subject to no gross income tax, but according to the revenue department, its corporate partners would be subject to gross income tax on their *net* income at the higher gross income tax rate, currently 1.20%.<sup>46</sup> Depending on the business' ratio of gross income to net income, the partners of the partnership may or may not pay in the aggregate less tax than the corporation.<sup>47</sup>

One final *caveat* about the taxation of partnerships should be noted. To the extent the Indiana Legislature has vacillated over the years in its approach to the taxation of partnerships, the same could be true in the future. Although partnerships, including corporate partnerships, are now exempted from gross income tax, adjusted gross income tax and supplemental net income tax, the legislature could revert to taxing all partnerships or just corporate partnerships. That, however, would be an unfortunate continuation of the confusion and vacillation about partnerships that have plagued Indiana for over a quarter of a century. We should not subject Indiana business to any further changes in this area. Stable tax policies are essential to business planning and development in Indiana.

### III. THE INTERSTATE COMMERCE EXEMPTIONS—RECENT DEVELOPMENTS

In 1961, Indiana enacted the first of what are now *six* interstate commerce exemptions for finished goods inventory present in the state on the date on which personal property tax is assessed.<sup>48</sup> The interstate commerce (or warehouse exemptions, as they have been called) have been expanded over the years, intended by the legislature to offer personal property tax relief to taxpayers who have a large volume of finished goods inventory in the state destined for shipment in interstate commerce.

The expansion of these exemptions is exemplified by the two most recently enacted. Indiana Code section 6-1.1-10-29 was amended in 1984<sup>49</sup> to provide that, under certain circumstances, inventory located in an Indiana warehouse on March 1 is not subject to property tax if the personal property is owned by a manufacturer or processor and is destined

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46. *Id.* § 6-2.1-2-3(b).

47. There is, of course, a question as to whether the Indiana Department of Revenue's position is even correct. Under Indiana Code sections 6-2.1-2-4 and 6-2.1-2-5, it is the *activity* that produced the income that is determinative of the applicable gross income tax rate. Income from "selling at retail" is taxable at the low gross income tax rate. IND. CODE § 6-2.1-2-4 (1988). In the above example, the *activity* that produced the income to the corporate partners is the selling of widgets at retail and, accordingly, that income should be taxed at the low gross income tax rate.

48. *Id.* §§ 6-1.1-10-29 to -30.

49. Act approved March 6, 1984, Pub. L. No. 41, § 2, 1984 Ind. Acts 548, 549.

for out-of-state shipment.<sup>50</sup> The main advantage of this and related sections is that the taxpayer may elect to "factor" its inventory destined for out-of-state shipment by using its previous twelve-months actual shipping experience rather than utilizing a specific identification method.<sup>51</sup> Prior to the enactment of Indiana Code section 6-1.1-10-29, Indiana manufacturers and processors could only qualify for the interstate commerce exemptions for inventory produced in the state if they had a firm order for each item of inventory identifying a specific out-of-state destination.

Similarly, Indiana Code section 6-1.1-10-29.3, added in 1987,<sup>52</sup> further expanded the availability of the interstate commerce exemption. Pursuant to this section, goods originating out-of-state that were shipped to a public or private warehouse in Indiana, repackaged and subsequently shipped to an out-of-state destination are also exempt from personal property tax.<sup>53</sup>

Notwithstanding the legislature's generosity with respect to the interstate commerce exemptions, taxpayers continue to misunderstand the exemptions, thereby losing the benefits of those exemptions for which they might otherwise qualify. The decision in *Gulf Stream Coach, Inc. v. State Board of Tax Commissioners*<sup>54</sup> emphasizes the care taxpayers must take in preparing their property tax returns in order not to waive the interstate commerce exemptions. In *Gulf Stream*, the taxpayer (Gulf Stream) manufactured and converted motor homes and travel trailers. Finished units, ready for delivery, were warehoused by Gulf Stream in an area separate from its manufacturing operation. Finished units were stored in a separate warehouse area until either a driver became available to transport the finished unit or Gulf Stream received an order for the finished units.<sup>55</sup>

At issue in this case was \$582,306 worth of finished units Gulf Stream had on hand but treated as sold. These particular units were

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50. *Id.* § 6-1.1-10-29.

Personal property owned by a manufacturer or processor is exempt from property taxation if the owner is able to show by adequate records that the property is stored and remains in its original package in an instate warehouse for the purpose of shipment, without further processing, to an out-of-state destination.

51. *Id.* § 6-1.1-10-29.5(b). Under this section a taxpayer may substantiate his exemption claimed pursuant to Indiana Code section 6-1.1-10-29 by using a ratio of the taxpayer's shipments to out-of-state destinations over the past twelve months to the taxpayer's total shipments over the past twelve months.

52. Act approved March 4, 1986, Pub. L. No. 58, 1986 Ind. Acts 867.

53. *Id.* § 6-1.1-10-29.3. Although the goods may be repackaged in Indiana, they cannot be subject to additional manufacturing or processing at that time. *Id.*

54. 519 N.E.2d 238 (Ind. T.C. 1988).

55. *Id.* at 239.



subject to binding, pre-existing purchase orders and Gulf Stream had removed them from its book inventory. In preparing its business personal property tax return, Gulf Stream omitted these units entirely. Accordingly, for property tax reporting purposes, Gulf Stream did not show these units as being in its inventory and did not claim any of these units as being exempt under the interstate commerce exemptions. However, some of these units were subject to binding orders from out-of-state customers and would have qualified for exemption.<sup>56</sup>

The Indiana Tax Court first addressed the question of whether the subject units, treated as sold and removed from Gulf Stream's book inventory, were properly omitted in computing Gulf Stream's inventory for Indiana business personal property tax purposes. Gulf Stream contended that the units did not have to be reported because their removal from the books was consistent with generally accepted accounting principles. The court, however, concluded that removal of inventory from the taxpayer's books for financial accounting purposes, even though proper and in accordance with generally accepted accounting principles, is not necessarily correct for *state tax accounting* purposes.<sup>57</sup> Quoting the United States Supreme Court, the court stated, "'A presumptive equivalence between tax and financial accounting . . . create[s] insurmountable difficulties of tax administration. . . . [I]f management election among acceptable options were dispositive for tax purposes, a firm, indeed, could decide unilaterally—within limits dictated only by its accountants—the tax it wished to pay.'"<sup>58</sup> The court then concluded:

The [State Tax Board's] regulations require full disclosure and 50 IAC 4.1-3-4 must be read to require disclosure of all units still under the control of the taxpayer. . . . The requirement of full disclosure is not a trap for the unwary, it is a clear and necessary procedure to insure fair and accurate administration of the property tax laws.<sup>59</sup>

The court also found that Gulf Stream's failure to comply with the statutes and regulations in reporting the subject units and in claiming the interstate commerce exemption on these units constituted waiver of that exemption to which the taxpayer may have otherwise been entitled.<sup>60</sup> The court gave short shrift to Gulf Stream's contention that, even though it had not complied with the statutory provisions for claiming an ex-

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56. *Id.* at 240.

57. *Id.* at 241 (emphasis added).

58. *Id.* at 241 (quoting *Thor Power Tools Co. v. Commissioner*, 439 U.S. 522 (1979)).

59. 519 N.E.2d at 241.

60. *Id.* at 242.

emption, it should be entitled to that exemption as a constitutional right under the Commerce Clause. The tax court observed that the Commerce Clause affords no personal constitutional right to any individual taxpayer.<sup>61</sup> Instead "the Commerce Clause defines the relationship between the federal government and the governments of the individual states as it relates to the free flow of commerce."<sup>62</sup> Judge Fisher stated further, "no personal rights, are conferred by provisions which dictate the structure of government."<sup>63</sup> Accordingly, Gulf Stream's failure to follow the proper procedures for claiming the interstate commerce exemptions was found to constitute the waiver of these exemptions. Finally, in a further word to the careless, the court found that the twenty percent penalty imposed upon a taxpayer who undervalues property on its tax return by more than five percent of the value that should have been reported is *nonwaivable*.<sup>64</sup>

A petition to transfer the *Gulf Stream* case to the Indiana Supreme Court is currently pending. The tax court's decision in *Gulf Stream* is, of course, consistent with the Indiana Court of Appeals' holding in *Indiana State Board of Tax Commissioners v. Stanadyne, Inc.*<sup>65</sup> that a taxpayer waives its entitlement to the interstate commerce exemptions by not properly claiming those exemptions on its return, as prescribed by Indiana Code section 6-1.1-10-31.<sup>66</sup> While admittedly it is a harsh result for a taxpayer to forever lose its entitlement to the interstate commerce exemptions by not making a proper claim on its return or by understating its claim on its return, the *Gulf Stream* decision is solidly based upon statutory law, as well as the law regarding the waiver of constitutional rights. Taxpayers who feel that the result is unfair and results in a windfall to the taxing units in which the inventory is located should recognize that the proper forum to petition for relief is the legislature, not the Indiana courts.<sup>67</sup>

Not only does a taxpayer have to properly claim the interstate commerce exemptions provided by Indiana Code sections 6-1.1-10-29 and 6-1.1-10-30, but that claim can only cover inventory *owned* by the taxpayer. In *State Line Elevator, Inc. v. State Board of Tax Commis-*

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61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.* at 243.

65. 435 N.E.2d 278 (Ind. Ct. App. 1982).

66. *Id.* at 283-84.

67. House Bill 1783, introduced in the 1989 General Assembly, would grant the interstate commerce exemptions to a taxpayer that correctly stated total tax liability on its return by excluding the exempt inventory but who was denied the exemption because it failed to file Form 103-W with its return. H.B. 1783 would apply to the years 1985, 1986, 1987 and 1988.



sioners,<sup>68</sup> the taxpayer, an Indiana grain elevator, stored grain owned by Indiana and Illinois farmers. State Line, however, did not take title to or become the owner of the grain. State Line reported all of the grain that it held (possessed) on its business personal property tax return, and then claimed an exemption under Indiana Code section 6-1.1-10-29 for the grain in its elevators destined for out-of-state locations. The State Tax Board denied State Line the exemption because State Line was not the owner of the property for which the exemption was sought.<sup>69</sup>

In determining whether a taxpayer can claim an interstate commerce exemption for property it does not own, the tax court strictly construed the language of Indiana Code section 6-1.1-10-29, which provides:

Personal property owned by a manufacturer or processor is exempt from property taxation *if the owner is able to show* by adequate records that the property is stored and remains in its original package in an in-state warehouse for the purpose of shipment, without further processing, to an out-of-state destination.<sup>70</sup>

The court concluded that the reference to the term "owner" supports the conclusion that the exemption should only be available to the owner of property. Thus, since State Line admitted that it was not the holder of legal title to the grain for which it sought an exemption, State Line could not properly claim the exemption.<sup>71</sup>

The tax court also rejected State Line's argument that, since it was treated as the owner of grain for purposes of assessment, it should be given the right of the owner to claim the exemption.<sup>72</sup> Under Indiana Code section 6-1.1-2-4(b), "the person holding, possessing, controlling or occupying" the property is *also* liable for property tax thereon, unless he establishes that the property is being assessed and taxed in the name of the owner, or the owner is liable for the taxes under a contract with that person.<sup>73</sup> State Line was assessed tax on the grain it held for others under Indiana Code section 6-1.1-2-4(b). The court concluded that State Line's assessment under Indiana Code section 6-1.1-2-4(b) was not based upon *ownership*, but instead was based upon the fact that State Line was a possessor who had not established that the property was assessed and taxed in the name of the owner. In short, the court held that,

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68. 528 N.E.2d 501 (Ind. T.C. 1988).

69. *Id.* at 502.

70. *Id.* (quoting IND. CODE § 6-1.1-10-29 (1988)) (emphasis supplied by court).

71. 528 N.E.2d at 502.

72. *Id.* Under Indiana Code section 6-1.1-2-4(a), the owner of property is liable for property taxes due thereon.

73. IND. CODE § 6-1.1-2-4(b) (1988).

while an owner *or* the possessor of inventory may have a personal property tax liability on that inventory, only the owner is entitled to claim the interstate commerce exemptions available for that inventory.<sup>74</sup>

Although the *State Line* decision expressly addressed only the exemption granted to manufacturers and processors under Indiana Code section 6-1.1-10-29, arguably its holding is equally applicable to the interstate commerce exemptions provided by Indiana Code sections 6-1.1-10-29.3, 6-1.1-10-30(a) and 6-1.1-10-30(c).<sup>75</sup> All of these exemption provisions similarly contain the operative words "if the owner is able to show by adequate records," which the tax court has interpreted to mean two things: (1) that the *owner* has to prove that the goods qualify for the exemption, and (2) that the availability of the exemption is limited to the *owner*, notwithstanding that someone other than the owner, such as the possessor, statutorily bears the property tax liability on the inventory.<sup>76</sup>

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74. 528 N.E.2d at 502-03.

75. Respectively, these sections provide in pertinent part:

Personal property shipped into Indiana is exempt from property taxation *if the owner is able to show by adequate records* that the property:

- (1) is stored in an instate warehouse for the purpose of transshipment to an out-of-state destination; and
- (2) is ready for transshipment without additional manufacturing or processing, except repackaging.

IND. CODE § 6-1.1-10-29.3 (1988) (emphasis added).

(a) Subject to the limitation contained in subsection (d) of this section, personal property is exempt from taxation if:

- (1) the property is owned by a nonresident of this state;
- (2) *the owner is able to show by adequate records* that the property has been shipped into this state and placed in its original package in a public or private warehouse for the purpose of transshipment to an out-of-state destination; and
- (3) the property remains in its original package and in the public or private warehouse.

*Id.* § 6-1.1-10-30(a) (emphasis added).

(c) Subject to the limitation contained in subsection (d) of this section, personal property is exempt from property taxation if:

- (1) the property has been placed in its original package in a public warehouse;
- (2) the property was transported to that public warehouse by a common, contract, or private carrier;
- (3) *the owner is able to show by adequate records* that the property is held in the public warehouse for purposes of transshipment to an out-of-state destination and is labeled to show that purpose; and
- (4) the property remains in its original package and in the public warehouse.

*Id.* § 6-1.1-10-30(c) (emphasis added).

76. See *State Line Elevator, Inc. v. State Bd. of Tax Comm'rs*, 528 N.E.2d 501 (Ind. T.C. 1988).



Whether the Indiana Legislature really intended this result is unclear. If the interstate commerce exemptions were enacted to provide property tax relief to those who held finished goods inventory in Indiana destined for shipment in interstate commerce, it really makes no sense to distinguish between "owners" and "possessors" in providing that kind of tax relief. Furthermore, the tax court may have construed the operative phrase more narrowly than intended by the legislature, since the "second" meaning noted above is the result of implication, rather than expression. Literally, these words require that the owner *prove* that the goods satisfy the various requirements for exemption.<sup>77</sup> This phrase does not expressly limit the exemptions to the legal owner of the goods.

In *RCA v. State Board of Tax Commissioners*,<sup>78</sup> the Indiana Tax Court confirmed, as many taxpayers had believed, that they were entitled to claim *more than one* of the interstate commerce exemptions for inventory pursuant to Indiana Code sections 6-1.1-10-29, 6-1.1-10-29.3 and 6-1.1-10-30.<sup>79</sup> RCA, a manufacturer of electronic audio and video equipment, owned finished goods inventory "which had been shipped into Indiana and placed into original packages in the warehouse for purposes of transshipment to in-state or out-of-state locations ('imported products'), [as well as] property which was produced in Indiana and placed in original packages in the warehouses for storage pending shipment ('domestic products')." <sup>80</sup>

Pursuant to Indiana Code section 6-1.1-10-30(a), RCA claimed an exemption for 98% of its *imported* products stored in its Indiana warehouses on March 1, 1986. This exemption was not disputed by the state tax board.<sup>81</sup> A second exemption for a portion of the *domestic* products stored in the warehouses was claimed under Indiana Code section 6-1.1-10-30(b). RCA used the specific identification method<sup>82</sup> to determine that 36.71% of its domestic products had been ordered and were ready for interstate commerce shipment to specific destinations to which the

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77. See, e.g., IND. CODE § 6-1.1-10-29.3 (1988) (property must be stored in an in-state warehouse for out-of-state shipment without requiring additional manufacturing or processing); *id.* § 6-1.1-10-30(a) (property must have been shipped to Indiana and put in its original package for out-of-state shipment).

78. 528 N.E.2d 125 (Ind. T.C. 1988).

79. *Id.*

80. *Id.*

81. *Id.*

82. IND. CODE § 6-1.1-10-29.5(b) (1988) states, in part:

(b) for the purpose of substantiating the amount of his personal property which is exempt from property taxation under section 29, 29.3, 30(a), or 30(c) . . . a taxpayer shall maintain records that reflect the specific type and amount of personal property claimed to be exempt so that the taxpayer's taxable personal property may be distinguished from his exempt personal property.

products were subsequently shipped.<sup>83</sup> Finally, RCA also claimed an exemption for *domestic* products stored and remaining in original packages for the purpose of out-of-state shipment. Utilizing the allocation method<sup>84</sup> and its shipping experience for the preceding twelve months RCA determined that 98% of its domestic inventory was targeted for out-of-state shipment.<sup>85</sup> Upon an examination of RCA's return, the state tax board disallowed the exemptions claimed by RCA under Indiana Code sections 6-1.1-10-29 and 6-1.1-10-30(b) on the basis that RCA was required to elect one statutory method of exemption.<sup>86</sup>

On RCA's appeal of the state board's decision, the state tax board argued that, "according to the language of Indiana Code section 6-1.1-10-29.5, the taxpayer must elect to use either the allocation method of Indiana Code section 6-1.1-10-29 *or* the specific identification method of Indiana Code section 6-1.1-10-30(b)"<sup>87</sup> and that RCA had in fact used both methods in arriving at its total exemption. The tax court, however, rejected this argument, noting that Indiana Code section 6-1.1-10-29.5 only provides a method for substantiating the taxpayer's exemption claim under Indiana Code sections 6-1.1-10-29, 30(a) or 30(c). In short, the court concluded that the election which the taxpayer makes under Indiana Code section 6-1.1-10-29.5 relates only to Indiana Code sections 6-1.1-10-29 and 6-1.1-10-30(a) and (c) and does not preclude the taking of the exemption provided by Indiana Code section 6-1.1-10-30(b).<sup>88</sup>

Judge Fisher also rejected the state tax board's argument that RCA had violated Indiana Code section 6-1.1-10-29.5's requirement that the allocation factor be applied to the "total inventory."<sup>89</sup> The board clearly

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83. 528 N.E.2d at 125.

84. As an alternative to the specific identification method, a taxpayer "may elect to establish the value of his exempt personal property by utilizing the allocation method." The statute sets out the formula for a determination under this method. IND. CODE § 6-1.1-10-29.5(b) (1988).

85. 528 N.E.2d at 125. In computing its exemption under Indiana Code section 6-1.1-10-29, RCA took the value of its domestic inventory, multiplied it by the 98% allocation factor, subtracted the value of the exemption it had claimed on its domestic inventory under Indiana Code section 6-1.1-10-30(b) and multiplied the remainder by 60%. The 60% multiplier represents that portion of the exemption that was phased in in 1986 pursuant to P.L. 41-1984, § 5. RCA then added all of its exemption claims together and deducted that sum from its reported inventory. 528 N.E.2d at 126.

86. *Id.*

87. *Id.* at 127 (emphasis in original).

88. *Id.*

89. According to the state board's findings:

[IND. CODE § 6-1.1-10-29.5 (1988)] prohibits *any* deductions from inventory *before* the appropriate percentages are applied under I.C. § 6-1.1-10-29. Therefore, a taxpayer cannot exempt inventory under I.C. § 6-1.1-10-30(b) and then apply



did not understand how RCA calculated its exemption claim because it asserted that RCA applied the allocation factor to its inventory after RCA deducted that portion of the domestic inventory for which an exemption was claimed under Indiana Code section 6-1.1-10-30(b). The court noted correctly that, in fact, RCA *had* complied with the law by applying the allocation factor (98%) to its total inventory and then deducting the value of the inventory it claimed to be exempted under Indiana Code section 6-1.1-10-30(b).<sup>90</sup>

The court also dismissed the state tax board's argument that RCA was simply trying to avoid the phase-in of Indiana Code section 6-1.1-10-29. The court's rejection of this argument was based upon the simple fact that RCA had indeed applied the phase-in percentage to the inventory that it claimed as being exempt under Indiana Code section 6-1.1-10-29, all in accordance with that statute.<sup>91</sup>

In conclusion, the court found that nothing in Indiana Code sections 6-1.1-10-29, 6-1.1-10-29.5 or 6-1.1-10-30(b) prohibits contemporaneous exemptions.<sup>92</sup> Noting that "[o]verlap is common among tax exemption statutes," the court found that taxpayers could qualify for more than one exemption.<sup>93</sup> Provided that RCA did not take two exemptions for the same inventory, the court held that nothing in the property tax laws prohibits it from calculating the exemptions in the manner that it did.<sup>94</sup>

The court correctly interpreted the interstate commerce exemptions in the *RCA* case. There is no reason to preclude taxpayers from qualifying for more than one of the interstate commerce exemptions, just as taxpayers can qualify for more than one of the many other tax exemptions granted by the legislature. As long as there is no express prohibition against a single taxpayer claiming two or more exemptions and there is no "double-dipping" by taxpayers claiming the same exemption twice, there is no support for the position that the state tax board took in *RCA*. The state tax board's insistence that RCA was entitled only to the interstate commerce exemption allowed by Indiana Code section 6-1.1-10-30(a) may have been the result of its perception that the legislature intended to curtail the availability of the interstate commerce exemption granted to manufacturers and processors by Indiana Code section 6-1.1-10-29 for the first few years after it was enacted. As noted earlier,<sup>95</sup>

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I.C. § 6-1.1-10-29 to the remainder because the allocation factor is not being applied against the total inventory.

528 N.E.2d at 127.

90. *Id.* at 128.

91. *Id.*

92. *Id.* at 129.

93. *Id.*

94. *Id.*

95. See *supra* notes 48-49 and accompanying text.

when the section was added in 1984, it was regarded as a boon to manufacturers and processors, and the exemption it provided was phased in over five years in an effort, *inter alia*, to reduce the revenue impact of this new exemption. RCA took advantage of this new exemption, but then also took advantage of the other existing exemptions. While there may have been valid tax or revenue policy reasons for limiting taxpayers to only one exemption, the fact is that the exemptions were not clearly drafted that way in 1983. The *RCA* decision correctly interprets the law as it was written and enacted.

Notwithstanding the availability of the interstate commerce exemptions, the personal property tax on inventory remains a substantial and, many argue, an unfair burden on Indiana businesses. In recent years, many taxpayers have tried to reduce that burden by claiming an adjustment for abnormal obsolescence in determining the true cash value of their inventory. One such taxpayer was Don Meadows Motors, Inc. (Meadows), an automobile dealer who claimed an abnormal obsolescence adjustment for its vehicle inventory.<sup>96</sup> The basis for the adjustment Meadows claimed was an unforeseen change in the market value of the vehicle inventory. The state tax board denied Meadows this adjustment and Meadows appealed.<sup>97</sup>

The tax court turned to the regulations of the state tax board<sup>98</sup> for direction in deciding this issue. The court first observed that the more *general* regulation addressing the issue of abnormal obsolescence provides that “[abnormal obsolescence] includes *unforeseen changes in market values*, exceptional technological obsolescence or destruction by catastrophe that has a direct effect upon the value of the personal property of the taxpayer.”<sup>99</sup> However, a more *specific* regulation concerning the valuation of inventory confines abnormal obsolescence to situations “where unforeseen changes in values as a result of exceptional technological obsolescence or destruction by catastrophe occur, providing that such events have a direct effect on the value of the inventory of the taxpayer.”<sup>100</sup> Although the more general regulation provides that unforeseen changes in market value may be a basis for an adjustment for abnormal obsolescence, the more specific regulation on valuing inventory does not list unforeseen changes in market value as a basis for such an adjustment.

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96. *Don Meadows Motors, Inc. v. State Bd. of Tax Comm'rs*, 518 N.E.2d 507 (Ind. T.C. 1988).

97. *Id.* at 508.

98. The court primarily relied on IND. ADMIN. CODE tit. 50, r. 4.1-3-9 in its decision to remand to the state board. 518 N.E.2d at 508-09.

99. 518 N.E.2d at 508 (quoting IND. ADMIN. CODE tit. 50, r. 4.1-7-1(c) (1988)) (emphasis added).

100. 518 N.E.2d at 508 (quoting IND. ADMIN. CODE tit. 50, r. 4.1-3-9 (1988)).



The tax court applied the rules of statutory construction to these regulations and concluded that the specific regulation controlled over the general provision regarding abnormal obsolescence. Thus, the narrower definition of abnormal obsolescence—*without* changes in market value as an enumerated factor—controls the valuation of inventory.<sup>101</sup>

Meadows argued that the absence of the “unforeseen changes in market value” factor in Indiana Administrative Code title 50, rule 4.1-3-9 was merely an oversight or typographical error and pointed out that in other provisions of Regulation 16 dealing with abnormal obsolescence (such as Indiana Administrative Code title 50, rule 4.1-2-8 dealing with depreciable personal property), the state tax board had *included* that factor. The tax court, however, determined that this was not a situation requiring the court to exercise its power to read words into a regulation to make the regulation workable or to give it complete sense. The court’s primary reason for this conclusion was that other provisions of Indiana Administrative Code title 50, rule 4.1-3, take account of changes in market conditions in valuing inventory. The court cited the fact that taxpayers are allowed to elect to value inventory on the prior calendar year average to avoid the burden of excess inventory.<sup>102</sup> Taxpayers are also allowed to elect to value inventory at the lower of cost or market value.<sup>103</sup> Both of these mechanisms give relief from the burden of excess inventory on the assessment date as a result of changes in market conditions.

In its conclusion, the court found that, although the bases of the state tax board’s denial would be relevant to an adjustment for obsolescence pursuant to Indiana Administrative Code title 50, rule 4.1-7-1, application of that section was erroneous. According to the court, the state tax board should determine an adjustment for abnormal obsolescence with respect to inventory pursuant to the requirements of Indiana Administrative Code title 50, rule 4.1-3-9, which *excludes* unforeseen changes in market values and market conditions as a criteria.<sup>104</sup>

#### IV. “SOLICITATION” UNDER PUBLIC LAW NUMBER 86-272 REVISITED

##### A. *Historical Perspective*

From the late nineteenth century through the first half of the twentieth century, successful constitutional challenges under the Commerce Clause<sup>105</sup> and the Due Process Clause<sup>106</sup> of the United States Constitution

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101. 518 N.E.2d at 509.

102. *Id.* (citing IND. ADMIN. CODE tit. 50, r. 4.1-3-5 (1988)).

103. 518 N.E.2d at 509 (citing IND. ADMIN. CODE tit. 50, r. 4.1-3-6 (1988)).

104. 518 N.E.2d at 509.

105. U.S. CONST. art. I, § 8, cl. 3.

106. U.S. CONST. amend. XIV, § 1.

served to prevent states from levying taxes on businesses engaging in interstate commerce where mere solicitation of orders was the sole activity in the taxing state or was dissociated from any intrastate sales.<sup>107</sup> In 1959, Justice Clark used the language that caused “concern and uncertainty”<sup>108</sup> in the commercial world and prompted Congress to act to reinforce the Commerce Clause and the Due Process Clause protections of interstate commerce by legislative fiat, thus, triggering additional protection under the Supremacy Clause.<sup>109</sup>

In *Northwestern States Portland Cement Co. v. Minnesota*,<sup>110</sup> Justice Clark wrote: “We conclude that net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing state forming *sufficient nexus* to support the same.”<sup>111</sup> The Court found a sufficient nexus to support the imposition of a Minnesota tax and a Georgia tax respectively on net income from sales in the taxing states, where the sales were shown to be “promoted by vigorous and continuous sales campaigns run through a central office located in the State.”<sup>112</sup> This activity was, in Justice Clark’s estimation, an affirmative answer to the “controlling question [of] whether the state has given anything for which it can ask return.”<sup>113</sup> The Court concluded that “[s]ince by ‘the practical operation of [the] tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred . . .,’ it ‘is free to pursue its own fiscal policies, unembarrassed by the Constitution.’”<sup>114</sup>

The holding in *Northwestern* was consistent with long-established doctrine under the Commerce Clause and the Due Process Clause in finding that the corporate activity, which included a sales-service office in both cases, was a sufficient nexus to trigger the taxing power of the state.<sup>115</sup> From a 1980’s perspective and after the four-part test devised

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107. See, e.g., *Norton Co. v. Illinois Dep’t of Revenue*, 340 U.S. 534 (1951); *Robbins v. Taxing Dist. of Shelby County*, 120 U.S. 489 (1887).

108. S. REP. NO. 658, 86th Cong., 1st Sess., reprinted in 1959 U.S. CONG. & ADMIN. NEWS 2548-49.

109. U.S. CONST. art. VI, cl. 2.

110. 358 U.S. 450 (1959).

111. *Id.* at 452 (emphasis added).

112. *Id.* at 465.

113. *Id.* (quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940)).

114. 358 U.S. at 465 (quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940)).

115. The Iowa corporation that was subject to the Minnesota tax maintained in Minneapolis a three-room leased sales office equipped with its own furniture and fixtures and under the supervision of an employee-salesman known as district manager. The activities



by the court in *Complete Auto Transit, Inc. v. Brady*,<sup>116</sup> the activities involved in *Northwestern*, particularly with respect to the local offices, appear to be clearly sufficient, under the Commerce Clause and the Due Process Clause, to trigger the taxing power of a state. Nevertheless, the *Northwestern* court was confronted for the first time with fact situations where the activities sought to be taxed were *exclusively* part of interstate commerce since no property was sold wholly within the state.<sup>117</sup>

The apprehension of the business community in the wake of *Northwestern* was that a "sufficient nexus" with the taxing state could be found in "sales within a State obtained through the mere solicitation of orders within the state by an out-of-State company having no other activities within the State."<sup>118</sup> Within seven months, Congress responded to this concern by taking urgent remedial action<sup>119</sup> in the form of Public Law 86-272.

Public Law 86-272 provides, in relevant part, as follows:

(a) No state, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a *net income tax* on the income derived within such State by any person from interstate commerce if the *only* business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

- (1) the *solicitation* of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection and, if approved, are filled by shipment or delivery from a point outside the State; and
- (2) the *solicitation* of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such

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of the foreign corporation subject to the Georgia tax included maintaining a sales-service office in Atlanta which served four states, in addition to Georgia. *Id.* at 453-56.

116. 430 U.S. 274 (1977). In *Complete Auto Transit, Inc. v. Brady*, the Court's test of the constitutionality of state taxes under the Commerce Clause is as follows: (1) the taxpayer must be sufficiently connected to the taxing state to justify the tax; (2) the tax must be fairly related to benefits provided the taxpayer; (3) the tax must be fairly apportioned; and (4) the tax must not discriminate against interstate commerce. *Id.* at 287. This test has been applied to state net income taxes. *See, e.g., Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980).

117. *See* 358 U.S. at 470 (Frankfurter, J., dissenting).

118. S. REP. NO. 658, 86th Cong., 1st Sess., *reprinted in* 1959 U.S. CODE CONG. & ADMIN. NEWS 2548-49.

119. *Id.*

customer to fill orders resulting from such solicitation are orders described in paragraph (1).<sup>120</sup>

This statute, which was enacted in the interest of national uniformity, spawned a plethora of state court decisions interpreting the word "solicitation."<sup>121</sup>

### B. *Indiana's Interpretation of "Solicitation"*

The most recent Indiana decision on this issue is found in *West Publishing Co. v. Indiana Department of Revenue*<sup>122</sup> which built upon a 1981 Indiana Supreme Court decision. In *West*, the Indiana Tax Court interpreted "solicitation" pursuant to the federal restriction on the state's power to tax provided in 15 U.S.C. 381-84.<sup>123</sup> The *West* decision arguably broadens the Indiana Supreme Court's interpretation of solicitation rendered in *Indiana Department of Revenue v. Kimberly-Clark Corp.*<sup>124</sup> and may require a re-evaluation of certain regulations promulgated by the Indiana Department of Revenue.

In *Kimberly-Clark*, the Indiana Supreme Court found that Kimberly-Clark was entitled to the federal exemption provided by Public Law 86-272 because its activities could be characterized as inextricably related to "solicitation."<sup>125</sup> The court determined Kimberly-Clark's "crucial activities" to be "1) conveying information to customers concerning inventory conditions or delays in shipments, 2) verifying destruction of damaged merchandise and 3) coordinating the delivery of merchandise for special promotions."<sup>126</sup> Based on the nature of these activities, the Indiana Supreme Court held that Kimberly-Clark's net receipts from these activities were not subject to Indiana's adjusted gross income tax.<sup>127</sup>

The court rejected a definition of "solicitation" that would merely recite a non-exclusive list of exempt activities gleaned from fact situations presented to other state courts. Instead, the court chose to adopt the rationale of the Pennsylvania Supreme Court in *United States Tobacco*

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120. Act approved September 14, 1959, Pub. L. No. 86-272, 73 Stat. 555 (codified at 15 U.S.C. § 381(a) (1982)) (emphasis added).

121. See, e.g., *Coors Porcelain Co. v. State*, 183 Colo. 325, 517 P.2d 838 (1973), cert. denied, 419 U.S. 874 (1974); *Jantzen, Inc. v. District of Columbia*, 395 A.2d 29 (D.C. 1978); *United States Tobacco Co. v. Commonwealth*, 478 Pa. 125, 386 A.2d 471, cert. denied, 439 U.S. 880 (1978).

122. 524 N.E.2d 1329 (Ind. T.C. 1988).

123. See *supra* note 120 and accompanying text.

124. 416 N.E.2d 1264 (Ind. 1981).

125. *Id.* at 1268.

126. *Id.* at 1267.

127. *Id.* at 1268.



*Co. v. Commonwealth*.<sup>128</sup> Relying on the Pennsylvania court's decision, the Indiana Supreme Court stated the rule as follows:

[E]ach case must be judged upon its own merits, with particular emphasis placed upon the totality of a corporation's activities within a state. No one or two corporate activities performed in a casual or infrequent manner should operate to remove the exemption provided by Public Law 86-272. Such activities are indicative of the extent of a corporation's activities within a state, but it is the entire operation which must be examined.<sup>129</sup>

The Indiana court also joined the Pennsylvania court's belief that "Congress perceived 'solicitation' as 'sundry activities . . . closely related to the eventual sale of a product'"<sup>130</sup> and that "'acts of courtesy'" in order to accommodate a customer were not "'beyond the realm of solicitation.'"<sup>131</sup> Finding specifically that Kimberly-Clark's activities were "inextricably related to solicitation" or "acts of courtesy," the court vacated the court of appeals' decision and affirmed the judgment of the trial court.<sup>132</sup> As a result, receipts generated by the activities of Kimberly-Clark's itinerant salesmen were exempt from Indiana's adjusted gross income tax.

In *West Publishing Co. v. Indiana Department of Revenue*,<sup>133</sup> the Indiana Tax Court was confronted with a situation where a foreign corporation (West) employed sales representatives who were engaged in activities other than conveying information, verifying distribution, coordinating deliveries and other activities directly related to a sale. West's employees engaged in acceptance and forwarding of deposit checks, as well as certain collection procedures.<sup>134</sup> Judge Miller<sup>135</sup> stated the rule in this manner: "Solicitation can include a variety of activities which are related to the eventual sale, and acts of courtesy rendered to a customer to *facilitate* a sale may properly be regarded as solicitation of the sale."<sup>136</sup> The court found that the "arguably non-sollicitous" acceptance of deposit checks was, under this definition, an aspect of solicitation and the

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128. 478 Pa. 125, 386 A.2d 471, *cert. denied*, 439 U.S. 880 (1978).

129. 416 N.E.2d at 1268 (citation omitted).

130. *Id.* (quoting *United States Tobacco Co. v. Commonwealth*, 478 Pa. 125, 139, 386 A.2d 471, 478, *cert. denied*, 439 U.S. 880 (1978)).

131. 416 N.E.2d at 1268.

132. *Id.*

133. 524 N.E.2d 1329 (Ind. T.C. 1988).

134. *Id.* at 1336. However, the court also noted the fact that the sales representatives "forwarded checks to West in a *minuscule* 8.15% of the transactions." *Id.* (emphasis added).

135. Presiding Judge, 4th Dist. Court of Appeals, sitting as a Special Judge.

136. 524 N.E.2d at 1336 (emphasis added).

forwarding of the checks to West in a "minuscule" percentage of the total transactions, was a "courtesy . . . in order to facilitate sales."<sup>137</sup>

In two instances, West's representative was arguably involved in collection procedures. Nevertheless, the court observed that "[the salesman] informed the customer that a present sale could not be approved unless the old balances were merged with the amount which would be due under the new sales contract. In these instances, his services amounted to nothing more than removing an obstacle to the sale."<sup>138</sup>

The court also commented that the Department of Revenue was assigning great importance to infrequently performed activities in order to tax West. The court found West's activities in Indiana to be limited to "solicitation of sales" and, therefore, West was entitled to the exemption.<sup>139</sup>

Under the *West* decision, arguably non-sollicitous activities, especially if infrequent, may either be considered "facilitating," "accommodating," or "acts of courtesy" in order to bring them under the "solicitation" rubric. This expanded definition of solicitation prompts a scrutiny of the regulations of the Department of Revenue.

For non-resident persons and corporations, Indiana imposes a net income tax<sup>140</sup> upon that portion "of the adjusted gross income derived from sources within Indiana."<sup>141</sup> Such income includes that which results from "doing business in a state."<sup>142</sup> According to the Indiana Department of Revenue's regulations, a taxpayer is "doing business" in Indiana if it operates a business activity within Indiana including the following:

- (1) Maintenance of an office or other place of business in the state
- (2) Maintenance of an inventory of merchandise or material for sale, distribution, or manufacture, or consigned goods
- (3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution
- (4) *Rendering services to customers in the state*
- (5) Ownership, rental or operation of a business or property (real or personal) in the state
- (6) Acceptance of orders in the state

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137. *Id.*

138. *Id.*

139. *Id.* at 1337.

140. Adjusted Gross Income Tax Act of 1963, ch. 32 (Spec. Sess.), 1963 Ind. Acts (Spec. Sess.) 82 (current version at IND. CODE §§ 6-3-1-1 to -28 (1988)).

141. IND. CODE § 6-3-2-1(a) (1988).

142. *Id.* § 6-3-2-2(a)(2).



(7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L. 86-272 to tax its net income.<sup>143</sup>

Although the Department's regulation allows an adjusted gross income tax to be imposed on a taxpayer "[r]endering services to customers in the state,"<sup>144</sup> the *West* decision appears to arguably narrow the scope of that subsection. It is possible, as a result of *West*, that if the services rendered can be characterized as "removing obstacles from a sale," "facilitating" "accommodating," or "acts of courtesy," especially if the services are infrequent, they are protected by Public Law 86-272 and exempt from taxation.<sup>145</sup> Such a conflict has yet to be addressed.

#### V. RESTRICTIONS ON CHANGES IN THE REVENUE DEPARTMENT'S INTERPRETATIONS OF TAX LAWS

Concerned about taxpayer's allegations that the Indiana Department of Revenue frequently reverses itself on its interpretations of Indiana's tax laws without any parallel change in the statutory law or regulations, the Indiana General Assembly responded with legislation precluding the effectiveness of any change in the Revenue Department's interpretation of any tax administered by the Department.<sup>146</sup> According to the recently enacted legislation, if a change in a revenue department's interpretation will increase the taxpayer's liability for that tax, such change must be adopted in a rule before it is effective. Specifically, the relevant part of the statute states:

(b) No change in the department's interpretation of a listed tax may take effect before the date the change is adopted in a rule under this section, if the change would increase a taxpayer's liability for a listed tax.<sup>147</sup>

Simply stated, the Indiana Revenue Department may change its interpretation of a tax law, increasing a taxpayer's liability only if that change is prospective in operation, and the change is effectuated by the formal promulgation of a regulation.

Since 1977, Indiana has had a law similar to Indiana Code section 6-8.1-3-3 that dealt only with interpretations of the gross income tax

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143. IND. ADMIN. CODE tit. 45, r. 3.1-1-38 (1988) (emphasis added).

144. *Id.* tit. 45, r. 3.1-1-38(4).

145. See *West Publishing Co. v. Indiana Dep't of Revenue*, 524 N.E.2d 1329 (Ind. T.C. 1988); *Indiana Dep't of Revenue v. Kimberly-Clark Corp.*, 416 N.E.2d 1264 (Ind. 1981).

146. Act approved April 27, 1987, Pub. L. No. 105, 1987 Ind. Acts 1613 (codified at IND. CODE § 6-8.1-3-3(b) (1988)).

147. IND. CODE § 6-8.1-3-3(b) (1988).

act,<sup>148</sup> and it has proven to be very beneficial to taxpayers. The expansion of this statutory restraint on the Department should result in increased fairness and consistency in the administration and collection from year to year of all types of Indiana taxes.

It is important to note that Indiana Code section 6-8.1-3-3 is *not* simply a codification of the concept of legislative acquiescence, such being that "a long adhered to administrative interpretation dating from the legislative enactment, with no subsequent change having been made in the statute involved, raises a presumption of legislative acquiescence which is strongly persuasive upon the courts."<sup>149</sup> Significantly, this statute is instead a legislative prohibition against any retroactive changes in departmental interpretations, no matter how long standing, that will increase a taxpayer's liability. Furthermore, there is no requirement or limitation in this new law that the interpretation the Department seeks to change already be in regulation form. It is, therefore, believed that this prohibition was intended to and does cover informal administrative interpretations, as well. Thus, Indiana taxpayers should be encouraged to preserve and maintain copies of old audit reports, correspondence with the Revenue Department, and other similar documentation because these could provide a basis in the future for establishing what the Revenue Department's administrative interpretation has been. If an interpretation results in an increase in the taxpayer's liability, this type of documentation will support the taxpayer's argument that such interpretation was imposed contrary to the statutorily mandated means.

#### VI. THE TAX COURT'S JURISDICTION OVER INHERITANCE TAX MATTERS

In *Blood v. Poindexter*,<sup>150</sup> the Indiana Tax Court found that its exclusive jurisdiction over final determinations of the Indiana Department of Revenue includes certain determinations by the Department regarding the inheritance tax liability of the estates of non-resident decedents, previously within the jurisdiction of the county probate courts.<sup>151</sup> In this case, the taxpayer argued that no final determination had been made by the Department, therefore, Indiana Code section 6-4.1-7-5 applied and provided for an appeal in the county probate court.<sup>152</sup> The De-

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148. Act approved April 29, 1981, Pub. L. No. 77, 1981 Ind. Acts 914 (codified at IND. CODE § 6-2.1-8-3 (1988)).

149. *Baker v. Compton*, 247 Ind. 39, 42, 211 N.E.2d 162, 164 (1965).

150. 524 N.E.2d 824 (Ind. T.C. 1988).

151. *Id.* at 825.

152. *Id.* at 824. That statute provides, in part:

(a) a person who is dissatisfied with an inheritance tax determination or an appraisal . . . may appeal the department's decision to:

(1) the probate court . . .

IND. CODE § 6-4.1-7-5(a) (1988).



partment asserted, and the tax court agreed, that a final determination had occurred, and an appeal was governed by Indiana Code section 33-3-5-2, which vested exclusive jurisdiction in the Indiana Tax Court.<sup>153</sup> In order to reach this conclusion, the tax court had to find that Indiana Code section 6-4.1-7-5 "was repealed by implication . . . [because] [i]t is not possible to give effect to the jurisdiction provisions of both . . . and still give effect to the intent of the Legislature in creating [the tax court]."<sup>154</sup> The *Blood* decision, which essentially restates the reasoning of the tax court in the 1987 *Herff Jones* decision,<sup>155</sup> evinces once again the tax court's determination that it—not ninety-two different county courts—should be the tribunal of first resort on all Indiana tax matters.

Under the inheritance tax laws, an inheritance tax is imposed upon certain property interests transferred by the decedent at the time of the decedent's death.<sup>156</sup> The statutory procedures and the authority responsible for determining the amount of inheritance tax liability vary depending on the Indiana residence status of the decedent. The personal representative of the resident decedent, with certain exceptions, must file an inheritance tax return with the probate court.<sup>157</sup> The personal representative of the non-resident decedent must file an inheritance tax return with the department.<sup>158</sup>

The determination of the net taxable value of the property interests transferred by a resident or non-resident decedent is made according to a statutory procedure.<sup>159</sup> In the case of a resident decedent, the county inheritance tax appraiser submits an appraisal report to the probate court,<sup>160</sup> and, after notice and hearing, the probate court determines the fair market value of the property transferred and the amount of inheritance tax due and enters an order stating the amount of the tax due.<sup>161</sup> In the case of a non-resident decedent, the Department determines

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153. 524 N.E.2d at 824. The statute cited by the Department states, in relevant part:

(a) The tax court . . . has exclusive jurisdiction over any case that arises under the tax laws of this state and that is an initial appeal of a final determination made by:

(1) the department of state revenue; or  
(2) the state board of tax commissioners.

IND. CODE § 33-3-5-2(a) (1988).

154. 524 N.E.2d at 825.

155. *Herff Jones, Inc. v. State Bd. of Tax Comm'rs*, 512 N.E.2d 485 (Ind. T.C. 1987).

156. IND. CODE §§ 6-4.1-2-1 to -4 (1988).

157. *Id.* § 6-4.1-4-1.

158. *Id.* § 6-4.1-4-7.

159. *Id.* § 6-4.1-5-1.

160. *Id.* § 6-4.1-5-6.

161. *Id.* § 6-4.1-5-10.

the fair market value of the property transferred and the amount of inheritance tax due and enters an order stating the amount of tax due.<sup>162</sup>

A person who is dissatisfied with an inheritance tax determination made by a probate court with respect to a resident decedent's estate may obtain a rehearing, a reappraisal and a redetermination of inheritance tax by petitioning the *probate court*.<sup>163</sup> A person who is dissatisfied with an inheritance tax determination or an appraisal made by the Department with respect to a property interest transferred by a non-resident decedent may also appeal to the *probate court*. The inheritance tax laws specifically provide that when such an appeal is initiated, with respect to a non-resident decedent, "[t]he [probate] court may decide all questions concerning the fair market value of property interests transferred by the decedent or concerning the inheritance tax due as a result of the decedent's death."<sup>164</sup>

Blood's decedent was a non-resident, thus the authority to enter the initial order stating the fair market value of the property and the inheritance tax due was vested in the Department.<sup>165</sup> Blood was dissatisfied with the appraisal and the inheritance tax determination made by the Department, so he appealed the determination to the Gibson Circuit Court, the probate court in that county. The Department promptly filed a motion to dismiss in the Gibson Circuit Court and a pleading in the tax court entitled "Motion for the Court to Exert its Exclusive Jurisdiction in this Cause."<sup>166</sup> The basis of the Department's motion was Indiana Code section 33-3-5-2, which states as follows: "The tax court has exclusive jurisdiction over any case that arises under the tax laws of this state and that is an initial appeal of a final determination made by: (1) the department of state revenue."<sup>167</sup>

Blood filed a Motion to Strike the Department's Motion to Dismiss on the grounds that the department's motion was insufficient as a matter of law. Concurrently, Blood filed a Motion to Strike the Department's motion in the tax court on the grounds that the motion was "impertinent and immaterial."<sup>168</sup>

In its resolution of this controversy, the tax court first recited a principle that it had previously announced in the *Herff Jones* case, namely, that "one of the reasons for the creation of [the Tax] court was to prevent ninety-two different interpretations of a panoply of tax

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162. *Id.* § 6-4.1-5-15.

163. *Id.* §§ 6-4.1-7-1 to -4.

164. *Id.* § 6-4.1-7-5(c).

165. *Id.* § 6-4.1-5-15.

166. 524 N.E.2d 824 (Ind. T.C. 1988).

167. IND. CODE § 33-3-5-2(a) (1988).

168. 524 N.E.2d at 824.



issues.”<sup>169</sup> The court then observed that it was impossible to give effect to Indiana Code sections 6-4.1-7-5 and 33-3-5-2 *and* achieve this legislative objective. Relying upon the basic rule of statutory construction that if two statutes are repugnant, then the later of the two controls, the tax court ruled that Indiana Code section 33-3-5-2 repealed Indiana Code section 6-4.1-7-5.<sup>170</sup>

Blood had also argued that the Department's order was not a “final determination,” and since the statute provided that the tax court shall have exclusive jurisdiction only over appeals from final determinations of the Department, the tax court was without jurisdiction over this matter. In response, the tax court observed that the Department itself had called its appraisal an order and a determination. Furthermore, according to the tax court, the appraisal was “the final step in the administrative process before resort may be had to the judiciary, and is, thus, a final determination.”<sup>171</sup>

Finally, in response to Blood's contention that the tax court was without statutory authority to hear its appeal *de novo*, thereby denying Blood the due process right to present evidence and witnesses, the tax court found that in such appeals under Indiana Code section 6-4.1 (Death Taxes), it could hear and consider all admissible evidence in a *de novo* proceeding. Judge Fisher wrote:

Blood also contends that because I.C. 33-3-5-1 refers to this Court as an “appellate court,” the standard of review is limited to a review of the Department's action for abuse of discretion, etc. This is not the law. This Court, as did the court having probate jurisdiction prior to July 1, 1986, may hear the case *de novo*. It may hear all admissible evidence presented to it for the first time in the judicial proceeding. This type of review affords due process.<sup>172</sup>

Unfortunately, the *Blood* decision creates an asymmetry in the inheritance tax laws, both procedurally and substantively. Under *Blood*, the county probate courts have lost their jurisdiction to determine the value of a non-resident decedent's estate for inheritance tax purposes, while they retain their jurisdiction to determine the value of a resident decedent's estate for inheritance tax purposes. Indiana inheritance tax valuation issues will thus be decided by two entirely different judicial forums, the ninety-two county probate courts *and* the Indiana Tax Court,

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169. *Id.* (citing *Herff Jones, Inc. v. State Bd. of Tax Comm'rs*, 512 N.E.2d 485, 491 (Ind. T.C. 1987)).

170. 524 N.E.2d at 825.

171. *Id.*

172. *Id.* (citation omitted).

dependent solely upon the residence of the decedent. Needless to say, this asymmetry has created a great deal of confusion among inheritance tax practitioners, many of whom urge that it be resolved by the legislature. There seems to be no policy reason to vest two different courts with the jurisdiction to hear the same matters. The eventual results will only be inconsistencies in determinations and confusion about the proper procedures to follow. Indiana needs a simple, uniform approach to inheritance tax matters, and, while that was the tax court's objective in the *Blood* decision, it is clear that the court cannot achieve that objective alone. The legislature must be urged to examine the inheritance laws and work to achieve that objective as well.





# Current Issues Affecting Indiana Tax Policy

LARRY J. STROBLE\*

RONALD D'AVIS\*\*

## I. INTRODUCTION

According to Justice Holmes, "[t]axes are what we pay for civilized society."<sup>1</sup> This statement would lead one to expect a certain civilized rationality in the procedures by which taxes are determined and assessed. Unfortunately, a close examination of most taxing statutes and regulations thoroughly dissipates any such expectation.

This Article focuses upon policy issues affecting three Indiana taxes. Of most immediate interest is the general reassessment of all real property in Indiana, which is currently underway.<sup>2</sup> Secondly, a recent revision of the Indiana Department of Revenue's regulations signifies an abrupt reversal of tax policy in the area of sales and use taxes.<sup>3</sup> Finally, an Indiana Supreme Court decision and its impact on Indiana's death tax scheme is critiqued.<sup>4</sup>

## II. GENERAL REASSESSMENT OF REAL PROPERTY FOR PROPERTY TAX PURPOSES

### A. *Effects of the General Reassessment*

A general reassessment of all real property in Indiana began<sup>5</sup> on July 1, 1987, and is scheduled to be completed by March 1, 1989.

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\* Partner, Barnes & Thornburg, Indianapolis. A.B., Indiana University, 1971; J.D., M.B.A., Indiana University School of Law—Bloomington, 1976.

\*\* Associate, Barnes & Thornburg, Indianapolis. B.A. Northern Arizona University, 1972; J.D., Indiana University School of Law—Indianapolis, 1987.

1. *Compania General de Tabacos v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

2. See *infra* notes 5-104 and accompanying text.

3. See *infra* notes 105-77 and accompanying text.

4. See *infra* notes 178-239 and accompanying text.

5. The Indiana General Assembly has ordered nine general assessments of real property since the comprehensive revision of the state's property tax laws enacted in 1919. The 1919 Act provided for general reassessments in 1919, 1922, and every four years thereafter. Act approved March 11, 1919, ch. 59, § 152, 1919 Ind. Acts 198, 281. A general reassessment was conducted in 1922. See *Hasse v. Bielefeld*, 197 Ind. 498, 150 N.E. 413 (1926). An amendment to the statute provided for the next general reassessment in 1925. Act approved February 27, 1925, ch. 27, 1925 Ind. Acts 67. See *Postlewaite v. Hasse*, 205 Ind. 396, 186 N.E. 761 (1933). A 1927 amendment provided for general



The valuations produced by the reassessment will be the basis for property tax assessments effective March 1, 1989, and the resulting taxes due in May and November, 1990.<sup>6</sup> The new valuations will remain in effect until a subsequent general reassessment, which is scheduled to be completed by March 1, 1997.<sup>7</sup> More than twenty bills were introduced in the 1989 session of the General Assembly to delay, phase in, or otherwise minimize the impact of the reassessment on various classes of taxpayers<sup>8</sup> In any event, if history is any guide the current general reassessment will prove to be a time of controversy and testing of the administrative and legal underpinnings of Indiana's property tax system.<sup>9</sup>

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reassessments in 1928 and 1932. Act approved March 7, 1927, ch. 91, 1927 Ind. Acts 233. After the 1932 reassessment, the General Assembly temporarily abandoned the scheme of compulsory quadrennial assessments and delegated to the State Board of Tax Commissioners the duty to decide whether statewide or local reassessments were necessary. Act approved February 24, 1937, ch. 19, 1937 Ind. Acts 58. *See County Bd. of Review v. Kranz*, 224 Ind. 358, 66 N.E.2d 896 (1946). Statutorily-mandated general reassessments were resumed with the 1950 reassessment. Act approved March 9, 1949, ch. 225, 1949 Ind. Acts 722. Since 1950, general reassessments have been ordered for 1962 (Act approved March 10, 1961, ch. 319, § 701, 1961 Ind. Acts 893, 903), 1969 (Act approved March 14, 1963, ch. 338, 1963 Ind. Acts 847), and 1979 (1978 Ind. Acts 806). A plan was adopted in 1969 to reassess real property annually in one-sixth of the state's counties so that all property would be reassessed within the six-year cycle. Act approved March 11, 1969, ch. 112, 1969 Ind. Acts 254. The plan was repealed before it was implemented. Act of February 22, 1972, *Pub. L. No. 49*, 1972 Ind. Acts 455. *See also Op. Att'y Gen.* 104 (1971).

6. IND. CODE § 6-1.1-4-4 (1988).

7. *Id.*

8. *Lawmakers Hope To Soften Tax Blow*, Indianapolis News, Feb. 14, 1989, at A4, col. 4-5.

9. Among the cases arising in connection with the 1979 general reassessment were *Lubbenhusen v. State Bd. of Tax Comm'r*, 496 N.E.2d 139 (Ind. Ct. App. 1986) *cert. denied*, 107 S. Ct. 1605 (1987); *State Bd. of Tax Comm'r v. Vermillion County Property Owners Association*, 490 N.E.2d 341 (Ind. Ct. App. 1986); *State Bd. of Tax Comm'r v. Smith*, 463 N.E.2d 493 (Ind. Ct. App. 1984); *Indiana State Bd. of Tax Comm'r v. Ropp*, 446 N.E.2d 20 (Ind. Ct. App. 1983) (state board's equalization order was upheld); *Indiana State Bd. of Tax Comm'r v. Brown*, 410 N.E.2d 1205 (Ind. Ct. App. 1980) (state board could not be enjoined from completing equalization proceedings); *Governours Square v. State Bd. of Tax Comm'r*, 528 N.E.2d 864 (Ind. T. C. 1987) (application of income method of valuation allowed in determining economic obsolescence of an apartment complex); *Meridian Hills Country Club v. State Bd. of Tax Comm'r*, 512 N.E.2d 911 (Ind. T. C. 1987) (golf course assessment upheld in part and invalidated in part); *Cambridge Square North v. Indiana State Bd. of Tax Comm'r*, Cause No. S582-0753 (Marion Superior Court, June 3, 1983) (state board erred in failing to apply the income method in determining the assessed value of an apartment complex, in disallowing an allowance for economic obsolescence, and in applying a formula for determining land values); *McCloskey v. State Bd. of Tax Comm'r*, Cause No. 37,226 (Hancock Circuit Court, October 24, 1977) (state board was enjoined from enforcing a regulation which applied a 30% inflation adjustment factor in arriving at the true cash value of real property).

Although the general reassessment can be expected to raise the overall assessed value of taxable property in most, if not all, taxing jurisdictions in the state, it should not, by itself, cause an increase in the actual amount of property taxes collected to fund local government. In this connection, the property tax levy is the product of the assessed value of taxable property in the taxing jurisdiction multiplied by the applicable tax rate. The property tax rate is mathematically adjusted in relationship to the total assessed value to produce the tax levy required to fund the local government budget.<sup>10</sup> The growth in the budget is subject to various statutory controls<sup>11</sup> which in turn govern the growth in the overall property tax burden. Rather than increase taxes, the intended and expected effect of general reassessment is to reallocate the property tax burden among different classes of taxpayers as their relative shares of the assessed value base change. It has been estimated that on average homeowners may experience an increase in property taxes of 14% from the 1989 reassessment. Farmers may enjoy an average reduction in taxes of 15%, and businesses may receive an average reduction of 5%. In absolute terms, it has been projected that \$99 million in property taxes will be shifted from farmers and businesses to homeowners.<sup>12</sup>

Much of this shift in the tax burden can be explained by the fact that business personal property and utility property are self-assessed annually and thus more closely reflect current values.<sup>13</sup> On the other hand, the increase in real property values resulting from price-level inflation is largely excluded from the assessment base between general reassessments.<sup>14</sup> During the interim, business personal property and

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10. IND. CODE § 6-1.1-17-1 to -19 (1988).

11. IND. CODE §§ 6-1.1-18-1 to -11 & 6-1.1-19-1 to -8 (1988). In addition, the state board of tax commissioners has been given special authority to adjust post-1988 tax rates in the case of certain tax levies—such as cumulative building funds—that are applied at fixed rates to the outstanding assessed value. Act approved May 4, 1987, Pub. L. No. 74, § 25, 1987 Ind. Acts 1394, 1411. Absent such adjustment, the actual tax paid would rise solely as a result of the general reassessment.

12. Memorandum from the Legislative Services Agency to the Commission on Tax and Financing Impact Policy (Aug. 24, 1988). See also L. DEBOER, PROJECTING THE IMPACT OF THE 1990 REASSESSMENT ON INDIANA COUNTY ASSESSMENT (June 1987) (available from Purdue University); L. DEBOER, THE INDIANA PROPERTY TAX ASSESSMENT SYSTEM: SIMULATIONS OF FOUR POLICY ALTERNATIVES (1987) (available from Purdue University Cooperative Extension Service) [hereinafter DEBOER, TAX ASSESSMENT SYSTEM]. The specific impact on individual taxpayers could vary dramatically from these averages depending on the specific taxing jurisdiction, the type of property involved, and various other factors.

13. IND. CODE §§ 6-1.1-2-2 & 6-1.1-8-25 (1988).

14. Consumer prices rose 100.3% between January 1975, and January 1985. *Consumer Price Index* (Rev. CPI-W Urban Wage Earners and Clerical Workers (All items (1967) = 100)). Construction costs as of January 1975, and January 1985, were used,



utility property assume a gradually increasing share of the property tax burden. General reassessment restores a rough parity between real property and personal property in terms of the prevailing price levels used to determine assessed values. However, this realignment occurs through a sudden, discrete adjustment.<sup>15</sup> This phenomenon is disconcerting to taxpayers and is typically accompanied by calls for legislative and administrative strategies to blunt, or at least delay, the impact on certain classes of taxpayers, such as homeowners.

As in past years, the general reassessment can be expected to increase the incidence of controversy and litigation regarding property taxes, as well as competition among classes of taxpayers for preferential treatment. These forces are likely to place considerable pressure on the state's property tax system and highlight the weaknesses in its legal and administrative structure.

### *B. Indiana's Approach to Property Tax Valuation*

A first step in understanding a state's property tax system is to identify the prevailing valuation standard and the allowable methods for estimating value. At least conceptually, if not always in practice, most states tie the assessment of property to market value or some uniform fraction thereof.<sup>16</sup> Terms such as "actual value," "fair cash value," or "true and actual value" are typically used in state statutes to denote market value,<sup>17</sup> defined generally as the price at which property can be sold by a willing seller to a willing buyer when both operate with knowledge of the facts and without duress.<sup>18</sup> The methodology applied to determine market value is by no means uniform. However, generally accepted appraisal principles recognize three basic methods for valuing property:<sup>19</sup> the market approach,<sup>20</sup> the income

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respectively, to determine reproduction cost schedules for purposes of the 1979 and 1989 general reassessments. See INDIANA STATE BOARD OF TAX COMMISSIONERS, *Foreword to REAL PROPERTY APPRAISAL MANUAL* (1976); INDIANA STATE BOARD OF TAX COMMISSIONERS, *Foreword to REAL PROPERTY ASSESSMENT MANUAL* (1986).

15. DeBoer, *Tax Assessment System*, *supra* note 12.

16. INTERNATIONAL ASSOCIATION OF ASSESSING OFFICERS, *IMPROVING REAL PROPERTY ASSESSMENT: REFERENCE MANUAL 2* (1978). See also INSTITUTE OF PROPERTY TAXATION, *PROPERTY TAXATION* § 2.01[1] (1987).

17. Note, *The Road to Uniformity in Real Estate Taxation: Valuation and Appeal*, 124 U. PA. L. REV. 1418, 1420 n.21 (1976).

18. INSTITUTE OF PROPERTY TAXATION, *supra* note 16, at § 2.01[1]; and INTERNATIONAL ASSOCIATION OF ASSESSING OFFICERS, *PROPERTY ASSESSMENT VALUATION* 21 (1977).

19. Allison & Brown, *Appraisal Theory and Practice in the Computerized Age*, in *ENCYCLOPEDIA OF REAL ESTATE APPRAISING* 9-10 (3d ed. 1978).

20. "The market approach, known also as the market data or sales comparison

approach,<sup>21</sup> and the cost approach.<sup>22</sup> Standard appraisal practice typically employs all three methods whenever possible to determine a final estimate of value.<sup>23</sup> As discussed below, it appears that the General Assembly and State Board of Tax Commissioners ("State Board") have departed from many of these familiar principles in the design and administration of Indiana's property tax system. Whether their approach can be sustained by the Indiana courts remains to be seen.

Professor Wade Newhouse, in his study of state constitutional requirements for uniformity and equality in taxation, has identified twelve categories of constitutional clauses and ranked them according to their strictness or permissiveness on the scales of universality and uniformity, *i.e.*, the extent to which all property must be included within the tax base and the degree to which all property must be uniformly taxed without classification as to effective rates.<sup>24</sup>

The cornerstone of Indiana's property tax system is Article X, section 1, of the Indiana Constitution, which provides:

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approach, results in a market value estimate derived from the analysis of recent sales of property similar to the property appraised." W. SHENKLE, *MODERN REAL ESTATE APPRAISAL* 133 (1978). "The comparative sales approach rests on the principle of substitution, which states that no commodity has a value greater than that for which a similar commodity—offering similar uses, similar utility and similar function—can be purchased within the reasonable time limits that the buyers' market demands." INTERNATIONAL ASSOCIATION OF ASSESSING OFFICERS, *supra* note 18, at 105.

21. The income approach is intended to determine the present value of the expected future earnings from the property in question. "In the *income approach*, the appraiser takes the net annual income and capitalizes it at an appropriate capitalization rate." W. SHENKLE, *supra* note 20, at 54 (emphasis in original). "The capitalization process restates market value by converting the future benefits of property ownership into an expression of present worth." INTERNATIONAL ASSOCIATION OF ASSESSING OFFICERS, *supra* note 18, at 203.

22. The cost approach estimates value by considering the cost of the property less depreciation. INTERNATIONAL ASSOCIATION OF ASSESSING OFFICERS, *supra* note 18, at 131; W. SHENKLE, *supra* note 20, at 157-58. The cost figure employed may be either actual cost, replacement cost, or reproduction cost depending on the circumstances. 1 J. BONBRIGHT, *THE VALUATION OF PROPERTY* at 140-50 (1937).

23. Allison & Brown, *supra* note 19, at 9-10. It has been suggested that under ideal circumstances in a purely competitive market, these three methods would produce identical valuations. However, in the real world markets are not perfect, and actual data may be unavailable for purposes of computation under the market comparison or income approach. Thus, in arriving at a single value the appraiser may have to harmonize different estimates produced by the three methods or may have to rely on less than all three. Note, *Tax Assessments of Real Property: A Proposal for Legislative Reform*, 68 YALE L.J. 335, 344-45 (1958) [hereinafter Note, *Tax Assessments*].

24. W. NEWHOUSE, *CONSTITUTIONAL UNIFORMITY AND EQUALITY IN STATE TAXATION* (2d ed. 1984).



The General Assembly shall provide, by law, for a uniform and equal rate of property assessment and taxation and shall prescribe regulations to secure a just valuation for taxation of all property, both real and personal.<sup>25</sup>

On the basis of its constitution, Indiana is ranked among the fourteen most restrictive states in this study, and it appears that it is only the specific authorization to the General Assembly to exempt intangible property that prevents Indiana's Constitution from being assigned to the most restrictive end of the scale.<sup>26</sup> With a few exceptions,<sup>27</sup> the Indiana courts have applied the uniformity clause of the Indiana Constitution as strictly as Professor Newhouse's study predicts. Over the years, several statutes,<sup>28</sup> regulations,<sup>29</sup> and informal assessment policies<sup>30</sup> have been struck down as violating the constitution's requirement for uniformity, equality, and just valuation.

The General Assembly has chosen to implement the constitutional mandate to prescribe regulations for the just valuation of property by

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25. IND. CONST. art. X, §1. This section also permits the Indiana General Assembly to exempt the following classes of property:

- (1) Property being used for municipal, educational, literary, scientific, religious or charitable purposes;
- (2) Tangible personal property other than property being held for sale in the ordinary course of a trade or business, property being held, used, or consumed in connection with the production of income, or property being held as an investment;
- (3) Intangible personal property.

*Id.* Motor vehicles, mobile homes, airplanes, boats, trailers, and similar property may also be exempted if an excise tax is imposed on such property instead. *Id.*

26. W. NEWHOUSE, *supra* note 24, at 475-504, 1902 (1984).

27. *See, e.g.,* Lutz v. Arnold, 208 Ind. 480, 512-20, 193 N.E. 840 (1935) (Treanor, C. J., concurring) (the concurring opinion was filed later and appears in a different volume of the North Eastern Reporter at 196 N.E. 702 (1935)).

28. *See* Huie v. Private Truck Council, Inc., 466 N.E.2d 435 (Ind. 1984) (taxation of indefinite situs property of interstate motor carriers); Wright v. Steers, 242 Ind. 582, 179 N.E.2d 721 (1962) (exemption for motor vehicles); Finney v. Johnson, 242 Ind. 465, 179 N.E.2d 718 (1962) (formula method for valuing household goods).

29. State Bd. of Tax Comm'rs v. Polygram Records, Inc., 487 N.E.2d 444 (Ind. Ct. App. 1985) (treatment of accrued royalties in valuation of musical recording inventory of record distributor); State Bd. of Tax Comm'rs v. Pioneer Hi-Bred Int'l, Inc., 477 N.E.2d 939 (Ind. Ct. App. 1985) (grain inventory held at different levels of trade); McCloskey v. State Bd. of Tax Comm'rs, Cause No. 37226 (Hancock Circuit Court, October 24, 1977).

30. Harrington v. State Bd. of Tax Comm'rs, 525 N.E.2d 360 (Ind. T.C. 1988) (boat marina assessment); Meridian Hills Country Club v. State Bd. of Tax Comm'rs, 512 N.E.2d 911 (Ind. T.C. 1987) (golf course assessment); Indiana State Bd. of Tax Comm'rs v. Lyon & Greenleaf Co., 172 Ind. App. 272, 359 N.E.2d 931 (1977) (fungible grain inventory taxed at different values depending on identity of owner).

directing the state board to promulgate its own administrative regulations for classifying property and determining values.<sup>31</sup> These regulations are the basis for determining "true tax value," the statutory valuation standard.<sup>32</sup> The local tax rates are applied to the property's "assessed value," which is 33 1/3% of its true tax value.<sup>33</sup> The statutes require that the state board's regulations base true tax value on certain enumerated factors and "any other factor the board determines by rule is just and proper."<sup>34</sup>

The regulations issued by the State Board for assessment of real property are sometimes referred to as Regulation 17 or as the "Real Property Assessment Manual."<sup>35</sup> Under Regulation 17, the true tax value of land (other than farm land) is based on market values using the sales comparison method of appraisal.<sup>36</sup> Farm land valuations are

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31. IND. CODE §§ 6-1.1-31-5, 6-1.1-31-6, & 6-1.1-31-7 (1988).

32. *Id.* § 6-1.1-31-5(a).

33. *Id.* § 6-1.1-1-3.

34. *Id.* § 6-1.1-1-3. In the case of real property, the enumerated factors are:

- (1) the proper classification of real property;
- (2) the size of real property;
- (3) the effects that location and use have on the value of real property;
- (4) the depreciation, including physical deterioration and obsolescence, of real property;
- (5) the cost of reproducing improvements;
- (6) the productivity or earning capacity of land; and
- (7) the true tax value of real property based on the factors listed in this subsection and any other factor that the board determines by rule is just and proper.

*Id.* § 6-1.1-31-6(b).

In the case of personal property, the enumerated factors are:

- (1) the proper classification of personal property;
- (2) the effect that location has on the value of personal property;
- (3) the cost of reproducing personal property;
- (4) the depreciation, including physical deterioration and obsolescence, of personal property; and
- (5) the true tax value of personal property based on the factors listed in this subsection and any other factor that the board determines by rule is just and proper.

*Id.* § 6-1.1-31-7(b).

The assessed value of public utility property is based on its "just value," which is determined by the state board based on several enumerated factors which the board "may" consider. *Id.* § 6-1.1-8-26. The total "unit value" of the utility, which is to be determined by the state board, is then allocated between "distributable property" and "fixed property" and assigned to the applicable taxing jurisdiction according to prescribed rules. *Id.* § 6-1.1-8-25.

35. The current regulations can be found in IND. ADMIN. CODE tit. 50, r. 2.1-1 to 2.1-6 (1988). The regulations issued for the 1969 and 1979 general reassessment were known as the *Indiana Real Property Appraisal Manual*. The 1979 regulations are set forth at IND. ADMIN. CODE tit. 50, r. 2-1 to 2-13 (1988).

36. IND. ADMIN. CODE tit. 50, r. 2.1-2-1(c) (1988). Alternatively, the "abstraction



derived by using the "productivity method." The regulations assign all farm land a base rate of \$495 per acre, which is adjusted by productivity factors supplied by the state board.<sup>37</sup> Real estate improvements are generally assessed on the basis of replacement cost, which is adjusted, in the case of residential property, for physical depreciation and "neighborhood desirability"<sup>38</sup> and, in the case of commercial and industrial property, for physical depreciation and obsolescence.<sup>39</sup>

The valuation of tangible personal property of a business is governed by separate regulations commonly known as Regulation 16.<sup>40</sup> Depreciable property assessments are based largely on historical book costs<sup>41</sup> with depreciation adjustments allowed under prescribed tables based on the property's actual age in relationship to the applicable cost recovery or useful life period for federal income tax purposes.<sup>42</sup> Inventory is also generally valued on the basis of actual book costs<sup>43</sup> subject to a flat downward 35% valuation adjustment.<sup>44</sup>

Public utility property is assessed under what is commonly known as Regulation 19.<sup>45</sup> Personal property owned by a public utility is generally valued using adjusted basis figures for federal income tax purposes (with some exceptions).<sup>46</sup> Real property values are based on Regulation 17.<sup>47</sup>

Even as Indiana's latest general reassessment nears its scheduled completion, the standard of value which these valuation techniques are intended to measure remains unclear. The statute does not define "value" as such but merely refers to the state board's regulations as the basis for determining taxable value.<sup>48</sup> The state board's regulations have been the statutory basis for real property valuations since 1950<sup>49</sup>

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method" can be used to calculate the value of improved land in a situation in the absence of sufficient samplings of vacant land sales. *Id.* tit. 50, r. 2.1-2-1(d).

37. *Id.* r. 2.1-2-2.

38. *Id.* r. 2.1-3-2 and 2.1-3-3.

39. *Id.* r. 2.1-5-1.

40. *Id.* r. 4.1-1-1 to 4.1-8-5 (for recent amendments, see 12 Ind. Reg. 818 (1989)).

41. IND. ADMIN. CODE tit. 50, r. 4.1-2-2 (1988).

42. *Id.* r. 4.1-2-6.

43. *Id.* r. 4.1-3-2.

44. *Id.* r. 4.1-3-8.

45. *Id.* r. 5-1-1 to 5-9-1 (for recent amendments, see 12 Ind. Reg. 527-30 (1988)).

46. IND. ADMIN. CODE tit. 50, r. 5-4-3 (1988). This section has been recently amended, and amendments can be found at 12 Ind. Reg. 528-30 (1988).

47. 12 Ind. Reg. 528 (1988) (to be codified at IND. ADMIN. CODE tit. 50, r. 5-4-2.5).

48. IND. CODE §§ 6-1.1-31-5(a), 6-1.1-31-6(b)(7), & 6-1.1-31-7(b)(5) (1988).

49. See Act approved March 9, 1949, ch. 225, 1949 Ind. Acts 722; Act approved March 13, 1959, ch. 316, 1959 Ind. Acts 819; Act approved March 10, 1961, ch. 319, 1961 Ind. Acts 893; Act approved March 18, 1975, Pub. L. No. 47, 1975 Ind. Acts 247.

and for personal property valuations since 1961.<sup>50</sup> The statutes contain a list of factors on which the state board's regulations are supposed to be based.<sup>51</sup> However, a 1984 amendment added the following statement after this list of factors:

With respect to the assessment of real property, true cash value does not mean fair market value. True cash value is the value determined under the rules of the state board of tax commissioners.<sup>52</sup>

A similar statement was added in connection with personal property valuation.<sup>53</sup> In addition, the amendments deleted from the list of factors the productivity or earning capacity of personal property and the capitalization of income from the use of personal property.<sup>54</sup> The amendments also eliminated capitalization of income from real property use.<sup>55</sup> The apparent purpose of these amendments was to sever Indiana's definition of value from any concept of market value determined by reference to either the market approach or the income approach.<sup>56</sup> Moreover, because of the statement that true cash value means "the value determined under the rules of the state board of tax commissioners,"<sup>57</sup> the statute might be read as a legislative declaration that taxable values should be divorced entirely from market value considerations however determined. That inference is reinforced by a 1986 amendment in which the term "true cash value"—which had been the

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Prior to 1950, the assessing officials were directed to consider several enumerated statutory factors in arriving at property tax values. IND. CODE ANN. §§ 64-103, 64-601, & 64-1019(b) (Burns 1951 Replacement). Thus, prior to 1950 local assessors appear to have had the discretion to use their own judgment in applying the statutory factors and not to have been bound by the State Board's interpretation of such factors as embodied in its regulations.

50. Act approved March 10, 1961, ch. 319, 1961 Ind. Acts 893; 1975 Ind. Acts 247.

51. See *supra* note 34 and accompanying text.

52. IND. CODE § 6-1.1-31-6(c) (1988).

53. *Id.* § 6-1.1-31-7(d).

54. Act approved March 2, 1984, Pub. L. No. 42, § 2, 1984 Ind. Acts 552, 554.

55. *Id.*

56. It is possible that Pub. L. No. 42-1984 was enacted in reaction to the decision in *Cambridge Square North v. Indiana Bd. of State Tax Comm'rs*, Cause No. 37226 (Marion County Sup. Ct., June 3, 1983) in which the court held that the state board could not deny the use of the income method in valuing real estate because IND. CODE § 6-1.1-31-6(b) (1982) expressly referred to earning capacity and capitalization of income. In addition, Regulation 17 apparently sanctioned the income method, although it never explained how valuations under the income and cost methods should be reconciled. IND. ADMIN. CODE tit. 50, r. 2-1-9 (1985) (repealed 9 Ind. Reg. 706 (1986)).

57. IND. CODE § 6-1.1-31-6(c) (1988).



statutory valuation standard since at least 1919<sup>58</sup>—was replaced by the term “true tax value.”<sup>59</sup>

In connection with its “sunset review” of the State Board, the Indiana Legislative Services Agency characterized the State Board as advocating the position that market values are not the basis for property tax assessments in Indiana.<sup>60</sup> The State Board’s administrative actions over the years have generally been consistent with this position.<sup>61</sup> More recently, in response to the 1984 statutory amendments, the State Board amended existing Regulation 17 to delete the principal reference to the income method of valuation<sup>62</sup> and eliminated the method entirely from the version of Regulation 17 issued for the 1989 general reassessment.<sup>63</sup> In addition, the state board has not attempted to apply even the cost approach as a true proxy for market values. As it did in the 1979 version of Regulation 17,<sup>64</sup> the State Board has applied an across-the-board 15% “discount” to actual replacement costs (determined by a state-wide study) in establishing the schedules in the 1989 version of Regulation 17.<sup>65</sup> Similarly, the State Board’s regulations for assessing farmland, business personal property, and utility property also contain features that tend to produce true tax values below market values derived according to accepted appraisal principles.<sup>66</sup>

### C. Critique of the “True Tax Value” System

The goals of a property tax system that bases assessment values on rules divorced from market values appear to be related primarily to improving the ease and cost of administration. Under such a regime,

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58. Act approved March 11, 1919, ch. 59, 1919 Ind. Acts 198.

59. Act approved March 11, 1986, Pub. L. No. 24, 1986 Ind. Acts 617 (codified as amended at IND. CODE § 6-1.1-1-3 (1988)).

60. INDIANA LEGISLATIVE SERVICES AGENCY, PERFORMANCE AUDIT OF STATE BOARD OF TAX COMMISSIONERS, STATE BOARD OF ACCOUNTS, TREASURER OF STATE’S OFFICE, BOARD OF DEPOSITORIES, DEPARTMENT OF REVENUE, INDIANA REVENUE BOARD, COMMON SCHOOL FUND, LAND DIVISION, OFFICE OF AUDITOR OF STATE 1 (May 1985) [hereinafter PERFORMANCE AUDIT].

61. Note, *Suggested Adjustments to Indiana Condominium and Property Tax Laws*, 10 IND. L. REV. 693, 725 (1977).

62. IND. ADMIN. CODE tit. 50, r. 2-1-9 (1985) (repealed 9 Ind. Reg. 706 (1986)).

63. IND. ADMIN. CODE tit. 50, r. 2.1-1-1 to 2.1-6-1 (1988).

64. PERFORMANCE AUDIT, *supra* note 60, at 4.

65. See *Reassessment Guidelines Ok’d*, Indianapolis News, May 27, 1986, at 11, col. 1; *Senator Says Property Tax May Leap 20%*, Indianapolis News, June 21, 1986, at 17, col. 5; and *Assessing Will Hit Home—Literally*, Indianapolis Star, June 25, 1986, at 1, col. 1. The study showed that construction costs had risen 100% between 1975 and 1985, but the state board increased the cost schedules by only 85%.

66. See *supra* notes 37, 41-47 and accompanying text. See also PERFORMANCE AUDIT, *supra* note 60, at 7.

the often intractable problems of ordinary appraisal practice would ideally fall away as the process of valuing property was reduced to the application of a set of mechanical rules and formulas that could be applied even by those with relatively minimal training. In addition, controversy and litigation would be reduced, with the ultimate issue being whether the applicable regulations were properly applied. The typically conflicting testimony of appraisal experts would not have to be weighed and reconciled. Finally, the discretion of local assessors would be greatly confined under such a system, and the conformity of their valuations with the requirements of the regulations would be subject to relatively easy verification by taxpayers and reviewing administrative boards or courts.<sup>67</sup>

However, even if it was assumed that comprehensive and consistent regulations could be developed to achieve such objectives, there are serious drawbacks to a system that rejects market value as the ultimate standard for assessment valuation. In general, assessing officials and taxpayers alike are left without any conceptual guideposts in developing the assessment regulations or in determining or evaluating actual assessments of individual properties.

First, under such a scheme, "value" comes to resemble "taxable income" under the Internal Revenue Code.<sup>68</sup> "Taxable income" is whatever Congress defines it to be (subject to some relatively non-obtrusive constitutional limitations). If "true tax value" is whatever the State Board's regulations define it to be, the State Board is thrust into the role of a legislative body, potentially subject to all the political forces typically directed at a legislature.<sup>69</sup>

Second, although even a market-value based assessment system can be criticized on various policy grounds,<sup>70</sup> the results can at least be

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67. Cf. Note, *Tax Assessments*, *supra* note 23, at 375.

68. *Id.* at 370.

69. A serious legal question also arises concerning whether the legislature can constitutionally delegate to the State Board the authority to define the taxable value standard. Cf. *Welsh v. Sells*, 244 Ind. 423, 435, 192 N.E.2d 753, 760 (1963) (the court held that a section of House Enrolled Act Number 1226 (1963) that authorized the Department of Revenue to modify the tax rate brackets set by law was an unconstitutional delegation of authority). *But cf.* *Taxpayers Lobby v. Orr*, 262 Ind. 92, 101, 311 N.E.2d 814, 818 (1974) ("The mere fact that the Act may require some interpretation . . . does [not] mean that the Act requires an unconstitutional exercise of legislative power by the Department of Revenue . . . [T]he Supreme Court has recognized that some discretion must be conferred upon an administrative body in the enforcement of tax laws."). *Id.* at 818-19. See also Note, *supra* note 61, at 731.

70. Ture, *Shortcomings of the Property Tax* in PROPERTY TAX REFORM: THE ROLE OF THE PROPERTY TAX IN THE NATION'S REVENUE SYSTEM 92 (1973) [hereinafter PROPERTY TAX REFORM] and Woodruff, *Strengths and Weaknesses of the Property Tax*, in PROPERTY TAX REFORM, *supra*, 99 & 105-09.



rationalized as distributing the burdens of taxation in rough proportion to what the underlying property is worth. Results under a system divorced from the market value standard are difficult to rationalize except by reference to political compromise.

Third, it becomes very difficult for taxpayers to evaluate the equity of their assessments *vis-a-vis* other taxpayers when market values are not the conceptual basis for assessment, especially when all or most valuations are fixed below prevailing market levels. A taxpayer typically can be expected to have some general notion of the market value of the taxpayer's own property. Thus, he or she can proceed with some degree of confidence in the uniformity of assessment practice in general if the taxpayer's property, as well as the property of others, is assessed at close to fair market value.<sup>71</sup> However, when most property, including his or hers, is assessed at less than fair market value, the taxpayer has no readily available means of gauging the uniformity of assessments relative to market values unless he or she knows the precise fraction of full value generally used to determine assessed value. If this fraction cannot be determined or if there is no uniform fraction, the taxpayer may have to resort to a sales/assessment ratio study, a statistical analysis intended to establish the average ratio of market value to assessed value. Very few taxpayers have the resources to undertake such a study.<sup>72</sup>

Aside from the weight of the policy arguments, a "true tax value" system not based on a fair market value standard must also be scrutinized under the Indiana Constitution.<sup>73</sup> It is on this score that the most serious doubts about the viability of such a system arise.<sup>74</sup>

The Indiana courts have not yet been required to state explicitly whether Indiana's constitutional mandate for uniform and equal assessment and just valuation requires property to be assessed at full fair market value or some uniform fraction thereof. However, in *Walter*

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71. Pajcic, Weber, & Francis, *Truth or Consequences: Florida Opts for Truth in Millage in Response to the Proposition 13 Syndrome*, 8 FLA. ST. U.L. REV. 593, 608 (1980); and Note, *supra* note 17, at 1426.

72. Note, *supra* note 17, at 1440-43. See also Note, *Inequality in Property Tax Assessments: New Cures for an Old Ill*, 75 HARV. L. REV. 1374 (1962). Fractional value assessment may also diminish the taxpayer's propensity to appeal even an unequal assessment of which he is aware simply because the variation from the norm appears to be less. Thus, a taxpayer might be willing to accept an assessment at 24% of fair market value when the average assessment fraction of all property is 20%. He would seem less likely, however, to accept an assessment at 120% of fair market value if full value was the standard. However, the inequality is the same in both cases. Pajcic, Weber & Francis, *supra* note 71, at 608.

73. IND. CONST. art. X, § 1. See *supra* note 25 and accompanying text.

74. Cf. Note, *Tax Assessments*, *supra* note 23, at 382; Note, *supra* note 61, at 726.

v. *Schuler*,<sup>75</sup> the Florida Supreme Court, after construing almost identical language in Florida's Constitution,<sup>76</sup> concluded that the constitutionally required "just valuation" of property was to be determined by the property's fair market value.<sup>77</sup> In that case, the court found it necessary to define the term "just valuation," which it referred to as "X," before it could rule on whether wide-spread assessment of property at varying fractions of market value violated the state's constitution:

"[F]air market value" and "just valuation" should be declared "legally synonymous" and that such is the best way to arrive at the definition of "X." The former term is a familiar one and it, in turn may be established by the classic formula that it is the amount a "purchaser willing but not obliged to buy would pay to one willing but not obliged to sell."<sup>78</sup>

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75. 176 So. 2d 81 (Fla. 1965).

76. At the time of the decision in *Walter v. Schuler*, Florida's constitution provided: "The legislature shall provide for a uniform and equal rate of taxation . . . and shall prescribe such regulations as shall secure a just valuation of all property, both real and personal." FLA. CONST. art. IX, § 1.

This language was present in the Florida Constitution between 1885 and 1968. A similar provision had existed in the 1868 constitution. W. NEWHOUSE, *supra* note 24, at 179. The "just valuation" requirement was also carried over into the 1968 constitution. FLA. CONST. art. VI § 4. Indiana and Florida provide an interesting comparison of two states in which property tax systems have developed under almost identical constitutional provisions but differing statutory schemes, administrative structures, and political and economic conditions. Coeppe & Fanchel, *Challenging Ad Valorem Real Property Assessments in Florida*, 3 J. ST. TAX'N 113 (1984); Hudson, *Florida's Property Appraisers*, 7 NOVA L.J. 477 (1983); Pajcic, Weber & Francis, *supra* note 71; Wershow, *Agricultural Zoning in Florida—Its Implications and Problems*, 13 U. FLA. L. REV. 479 (1960); Wershow, *Ad Valorem Taxation and Its Relationship to Agricultural Land Tax Problems in Florida*, 16 U. FLA. L. REV. 521 (1964); Wershow, *Ad Valorem Assessments in Florida—Whither Now?*, 18 U. FLA. L. REV. 9 (1965); Wershow, *Recent Developments in Ad Valorem Taxation*, 20 U. FLA. L. REV. 1 (1967); Wershow, *Regional Valuation Board—A British Answer to Ad Valorem Assessment Problems in Florida*, 21 U. FLA. L. REV. 324 (1969); Wershow, *Ad Valorem Assessments in Florida—The Demand for a Viable Solution*, 25 U. FLA. L. REV. 49 (1972); Wershow & Schwartz, *Ad Valorem Assessments in Florida—Recent Developments*, 36 U. MIAMI L. REV. 67 (1981); Note, *Ad Valorem Taxation—Agricultural Classifications—The Continuing Preferential Tax Treatment Accorded the Florida Land Speculator*, 7 FLA. ST. U.L. REV. 571 (1979); Note, *The Florida Constitution and Legislative Classification for Tax Assessment Purposes*, 17 U. FLA. L. REV. 609 (1965); Note, *"Fogg" Lingers Over the Supreme Court of Florida*, 39 U. MIAMI L. REV. 549 (1985).

77. 176 So. 2d at 85-86.

78. *Id.* (citation omitted). The Arkansas Supreme Court has also held that fair market value assessment was necessary to satisfy a constitutional requirement that "[a]ll property subject to taxation shall be taxed according to its value" as well as the requirement that the values be "equal and uniform throughout the State." *Arkansas Pub. Serv. Co. v. Pulaski County Bd. of Equalization*, 266 Ark. 64, 582 S.W.2d 942 (1979). See also



Although the Indiana courts have not yet faced this issue squarely, it is nonetheless clear that in prior decisions the Indiana courts have not permitted either the Indiana General Assembly or the state board to define value for tax purposes as the mechanical end product of formulas adopted primarily for the sake of administrative convenience.

In a 1961 statutory amendment,<sup>79</sup> the Indiana General Assembly dealt with the difficulty of accurately valuing household goods by providing that such goods would have an assessed value equal to 5% of the assessed value of the improvements on the real estate on which the household goods were kept and maintained.<sup>80</sup> However, in *Finney v. Johnson*<sup>81</sup> the Indiana Supreme Court held that such provision, although simplifying and increasing the effectiveness of assessment and taxation of household goods, nonetheless violated the just valuation requirements of article X, section 1, of the Indiana Constitution.<sup>82</sup>

In *Indiana State Board of Tax Commissioners v. Lyon and Greenleaf Co.*,<sup>83</sup> the state board's regulations provided that raw wheat belonging to farmers should be taxed at sixty cents per bushel while raw wheat inventory held by a dealer or manufacturer was valued at the lower of actual cost or current replacement cost. Consequently, commingled wheat could be taxed at two different values depending on the identity of the owner. The court recognized that the constitutional requirements for uniformity, equality, and a just valuation were interdependent; uniformity and equality result when property is assessed at a just valuation. It further recognized that the authority granted to the Indiana General Assembly to "prescribe regulations to secure a just valuation" allowed it to establish the "mode by which the valuation of all property shall be ascertained."<sup>84</sup> Although actual cost was one of the statutory factors on which the state board was allowed to base its regulations, the court concluded that cost and "value" are not necessarily equivalent within the meaning of article X, section 1, of the Indiana Constitution:

While it is true that the relevant statutes recognize cost as a factor to consider in arriving at a just valuation, such factor

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Rocky Mountain Oil & Gas Ass'n v. State Bd. of Equalization, 749 P.2d 221, 232 (Wyo. 1987).

79. Act of March 11, 1961, ch. 325, 1961 Ind. Acts 959.

80. Household goods were subject to taxation until a constitutional amendment was approved by the general assembly in 1963 and 1965. See Act of April 20, 1963, ch. 48 (Spec. Sess.), 1963 Ind. Acts Spec. Sess. 228; Act approved March 9, 1965, ch. 482, 1965 Ind. Acts 1452. The amendment was approved by the electorate in 1966.

81. 242 Ind. 465, 179 N.E.2d 718 (1962).

82. *Id.* at 466, 179 N.E.2d at 719.

83. 172 Ind. App. 272, 359 N.E.2d 931 (1977).

84. *Id.* at 276, 359 N.E.2d at 934.

is not a sufficient condition to satisfy the constitutional requirements. Thus, a method of cost valuation which does not move towards the goal of securing a just valuation of all property on the principles of uniformity and equality cannot withstand constitutional attack.<sup>85</sup>

As these cases illustrate, the courts not only did not equate taxable value with the value determined by statute or the state board's regulations, but they obviously perceived just valuation as an objective standard against which such statutes and regulations are to be measured.

#### *D. Elements of a "Just Valuation" Property Tax System*

An efficient property tax system—at least one that can function under a constitutional uniformity provision such as Indiana's—must necessarily adopt a standard of value tied to the generally recognized principle that value "is the ability of a commodity to command another commodity (money) in exchange."<sup>86</sup> Known as exchange value, this amount represents, in principle, an objective value assigned to property by the marketplace.<sup>87</sup>

In estimating exchange value, orthodox appraisal practice requires application of the three standard methods of valuation, with each result operating as a check on the other in arriving at a final valuation.<sup>88</sup> Reproduction cost (or replacement cost) less depreciation is often suggested as a ceiling on valuation on the ground that property should not be valued at an amount in excess of what it would cost to replace the property with an effective substitute.<sup>89</sup> In some cases, property assessments have been approved on the ground that they reflect "use value," *i.e.*, a value that exceeds exchange value because it reflects the subjective value afforded to property based on a specific use or user. Use value may not be fully reflected in the property's market price (or exchange value) because prospective purchasers would not derive the same utility from the property as the current owner.<sup>90</sup> Usually

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85. *Id.* (footnote omitted). See also *State Bd. of Tax Comm'rs v. Pioneer Hi-Bred Int'l, Inc.*, 477 N.E.2d 939 (Ind. Ct. App. 1985), and *State Bd. of Tax Comm'rs v. Polygram Records, Inc.*, 487 N.E.2d 444 (Ind. Ct. App. 1985).

86. INTERNATIONAL ASSOCIATION OF ASSESSING OFFICERS, *supra* note 18, at 16.

87. Hazen & Janata, *Value Concepts in Property Taxation and Cost Approach as Applied to Real Estate, Machinery & Equipment and Unitary Value Concepts* in N.Y.U. 2D ANN. INST. ON ST. & LOCAL TAX'N AND CONF. ON PROP. TAX'N § 16.02[2][a] (1984) [hereinafter *Value Concepts*].

88. See *supra* notes 19-23 and accompanying text.

89. See Note, *supra* note 17, at 1432-33; 1 J. BONBRIGHT, *supra* note 22, at 156.

90. *Value Concepts*, *supra* note 87, at § 16.02[2][c]. See also 1 J. BONBRIGHT, *supra* note 22, at 14-16; Hazen, *The Pure Property Tax as Applied to Industrial Property* in N.Y.U. 3D ANN. INST. ON ST. & LOCAL TAX'N AND CONF. ON PROP. TAX'N § 18.05[1] (1985) [hereinafter *Pure Property Tax*].



these cases involve specialized property, in which instance an assessment based on use value may justify application of the reproduction cost approach even though an income or market value approach would result in a lower valuation.<sup>91</sup>

However, the important point is that the standard of value concept—whether exchange value or use value—should not be confused with the different issue of the appropriate valuation technique or techniques to be used in estimating such value. As suggested by the court in *Lyon & Greenleaf*, a property tax system which elevates the cost method of valuation to the position of a standard of value in its own right will fail to meet the mandates of the Indiana Constitution in given situations.<sup>92</sup> Conversely, an attempt to exclude entirely the income method or the market comparison method of appraisal will also likely contravene the constitution in situations where they provide clear, probative evidence of market value and where reproduction cost cannot be supported as the single best indication of value, as is sometimes advocated in the case of highly specialized property.<sup>93</sup> These observations draw into question the constitutional validity of the recent changes in the property tax statutes and Regulation 17, which attempt to abolish all consideration of market values or the income method of valuation.<sup>94</sup>

The appropriate standard of value for tax assessments should also not be confused with the standards applicable to judicial review of administrative determinations. In articulating the standards for judicial review, the courts have held that decisions of the State Board should be upheld unless they are arbitrary, capricious, an abuse of discretion, unsupported by substantial evidence, or in excess of statutory authority.<sup>95</sup> In *State Board of Tax Commissioners v. Chicago, Milwaukee,*

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91. *Value Concepts*, *supra* note 87, at § 16.02[2][c].

92. *Indiana State Bd. of Tax Comm'rs v. Lyon and Greenleaf Co.*, 172 Ind. App. 272, 275, 359 N.E.2d 931, 933 (1977).

93. *Cf. Value Concepts*, *supra* note 87; *Pure Property Tax*, *supra* note 90.

94. *See supra* notes 55-63 and accompanying text. There are also serious questions about the constitutionality of the numerous exemptions and deductions provided under Indiana's property tax laws. *See Note, Uniform Property Taxation in Indiana—The Need for a Constitutional Amendment*, 38 IND.L.J. 72 (1962). *See also* W. NEWHOUSE, *supra* note 26, at 501-02. Ranging from deductions for the blind and disabled [IND. CODE §6-1.1-12-11 (1982)] to tax credits for inventory in an enterprise zone [IND. CODE §6-1.1-20.8-1 (Supp. 1988)], the adjustments for specific classes of taxpayers have not been reviewed by the courts. *Cf. State ex rel. Tieman v. Indianapolis*, 69 Ind. 375 (1879) (property tax deduction for widows and orphans was unconstitutional).

95. *See, e.g., State Bd. of Tax Comm'rs v. Gatling Gun Club, Inc.*, 420 N.E.2d 1324 (Ind. Ct. App. 1981); *American Juice, Inc. v. State Board of Tax Comm'rs*, 527 N.E.2d 1169 (Ind. T.C. 1988); *Indiana Ass'n of Seventh Day Adventists v. State Bd. of Tax Comm'rs*, 512 N.E.2d 936 (Ind. T.C. 1987); *Meridian Hill Country Club v. State Bd. of Tax Comm'rs*, 512 N.E.2d 911 (Ind. T.C. 1987).

*St. Paul & Pacific Railroad*,<sup>96</sup> a 1951 case, the Indiana Supreme Court declared that a taxpayer is not entitled to judicial relief even if the taxpayer can show that a valuation method different from that used by the State Board would have produced a lower assessment. The court stated that the State Board is not required to use any particular valuation method in fixing assessments so long as the result is not "fraudulent, capricious, or arbitrary."<sup>97</sup> Thus, the court granted the State Board a measure of discretion in determining property tax values although it did not spell out the standards to be used in deciding whether a given valuation would be treated as arbitrary and capricious.<sup>98</sup>

Given the imprecision of the appraisal process and the well-established limits on judicial review of administrative decisions, the State Board must be allowed flexibility in setting assessed values or prescribing valuation regulations to be used by lower level assessors. However, as the cases demonstrate,<sup>99</sup> that flexibility is not unlimited, and the assessment results must be evaluated according to some identifiable standard. Although no Indiana court has yet so held, one approach would be to uphold an assessment if the methodology upon which it is based is within the broad range of generally accepted appraisal principles. The fact that a certain appraiser might have reached a different result would not invalidate the assessment as long as it could be established that the state board's valuation was within the reasonable range supportable under sound appraisal principles. This standard of review would further the goal of requiring accurate market value assessments but would avoid unrestrained judicial second guessing of the state board's valuation determinations.

Adoption of a market value-based valuation standard, coupled with the requirement that assessments be supportable under generally accepted appraisal principles, would appear to further the constitutional goals of uniformity, equality, and just valuation. The burden of the property tax would be spread more closely in accordance with the value of the underlying property. To the extent available, prevailing market values would serve as a guide in evaluating assessments and would permit adjustments in the assessments as needed to sustain uniformity.

Although a fully-realized property tax system based on this model might not be feasible in practice, it appears likely that even a reasonable approximation would contribute substantially to the improvement of

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96. 121 Ind. App. 302, 96 N.E.2d 279 (1951).

97. *Id.* at 310, 96 N.E.2d at 283. *See also* Indiana State Bd. of Tax Comm'rs v. Traylor, 141 Ind. App. 324, 229 N.E.2d 46 (1967). *Cf.* State Bd. of Tax Comm'rs v. Valparaiso Golf Club, Inc., 164 Ind. App. 687, 330 N.E.2d 394 (1975).

98. 121 Ind. App. at 310, 96 N.E.2d at 283.

99. *See supra* notes 28-30.



uniformity. However, the costs of implementing such a sophisticated system—both in the commitment of resources and the restructuring of administrative procedures—cannot be ignored.

To perform its duty of administering a mass appraisal system, the State Board must be allowed to prescribe regulations that rely to a degree on short-hand formulas, rules of thumb, and uniform cost schedules. However, to approximate market values, such regulations need to be relatively faithful to recognized appraisal concepts. Thus, the regulations should allow the use of the income method of valuation for certain types of properties, allow consideration of actual sales prices of comparable properties, recognize the distinction between the actual age and the effective age of property,<sup>100</sup> permit indexation of cost figures to reflect inflation, and set forth guidelines for estimating functional and economic obsolescence.<sup>101</sup> How far the State Board should be required to go in incorporating sophisticated appraisal techniques in its regulations is admittedly a difficult issue. Moreover, to the extent that the regulations prescribe such appraisal techniques, local assessors would undoubtedly require increased training and resources, and the amount of their discretion in determining values would inevitably grow. Greater local discretion could arguably open up the possibility of abuse, which then could require a greater commitment of resources at the state level to monitor local assessment practices. In addition, application of the market comparison method, which appears to be officially sanctioned under current Regulation 17 only in the area of residential and commercial land values,<sup>102</sup> is seriously hampered by the absence of any requirement that accurate sales price data be set forth on deeds, a common requirement in many states.<sup>103</sup> Thus, an effective property tax system might also require adoption of a law requiring disclosure of this information.<sup>104</sup> Finally, because of

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100. Cf. PERFORMANCE AUDIT, *supra* note 60, at 4 (Legislative Services Agency criticized the 1979 version of Regulation 17 for basing depreciation on actual age).

101. Regulation 17, governing real property assessments, presently allows an adjustment for economic and functional obsolescence but gives little guidance concerning how such obsolescence should be measured or whether a capitalized earnings approach could be used for this method. IND. ADMIN. CODE tit. 50, r. 2.1-5-1 (1988). Thus, having officially banished the income method from Regulation 17, the State Board may have permitted it to re-enter through the back door as a means of quantifying obsolescence.

102. See *supra* note 36 and accompanying text.

103. Benshoof & Gibson, *Trial of Tax Discrimination Case Under the 4-R Act*, N.Y.U. 2D ANN. INST. ON ST. & LOCAL TAX'N AND CONF. ON PROP. TAX'N § 20.06[4] (1984).

104. Cf. MODEL REAL PROPERTY TRANSFER INFORMATION ACT, art. 2, § 2.1(a)(11) (American Bar Association Legislative Recommendation No. 1987-1, approved Aug. 1988).

shifting values of individual properties as well as general price level changes, the cycle for the general reassessment of real estate should be more frequent than once every eight to ten years.<sup>105</sup>

The price of achieving genuine fairness and equity in property taxation may not be cheap. However, Indiana's constitutional provisions for uniformity, equality, and just valuation may yet require either that this price be paid or that the constitution be amended to provide the Indiana General Assembly more latitude in defining "value" and in distinguishing among different classes of taxpayers.

### III. NEW SALES TAX REGULATIONS INTERPRETING THE SALES TAX MANUFACTURING EXEMPTION

The year's most significant development in the sales tax area was the promulgation by the Indiana Department of Revenue of revised sales tax regulations on September 1, 1987.<sup>106</sup> The promulgation of the new regulations, together with two decisions of the court of appeals, effectively ended a long standing dispute between taxpayers and the department about the precise contours of several sales and use tax exemption statutes. The new regulations largely adopt the taxpayers' position, and in issuing the new regulations the department has conceded defeat for its prior interpretation.

#### A. *The Manufacturing Exemption*

When enacted in 1963,<sup>107</sup> Indiana's sales and use tax statutes provided an exemption for the sale of "manufacturing machinery, tools and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining or finishing of tangible personal property."<sup>108</sup> Additional exemptions were provided for agricultural equipment,<sup>109</sup> property used to produce manufacturing or agricultural equipment,<sup>110</sup> and materials consumed in production of food and commodities for sale.<sup>111</sup>

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105. Cf. DEBOER, TAX ASSESSMENT SYSTEM, *supra* note 12.

106. 10 Ind. Reg. 2610 (1987).

107. Act approved April 20, 1963, ch. 30 (Spec. Sess.), 1963 Ind. Acts (Spec. Sess.) 60.

108. IND. CODE ANN. § 64-2654(b)(6) (Burns Supp. 1964) (current amended version at IND. CODE § 6-2.5-5-3(b) (1988)).

109. IND. CODE ANN. § 64-2543(b)(6) (Burns Supp. 1964) (current amended version at IND. CODE § 6-2.5-5-2 (1988)).

110. IND. CODE ANN. § 64-2654(b)(6) (Burns Supp. 1964) (current amended version at IND. CODE § 6-2.5-5-4 (1988)).

111. IND. CODE ANN. § 64-2654(b)(1) (Burns Supp. 1964) (current amended version at IND. CODE § 6-2.5-5-1 (1988)).



The policy rationale for such exemptions, sometimes termed the "producer's goods exemptions,"<sup>112</sup> is that a sales tax is designed to tax consumer expenditures. "If goods used in production are taxed as well as the final products, an element of multiple taxation of the same consumer expenditures is introduced."<sup>113</sup> The difficulty arises in determining whether an item acquired by a producer should be taxed as a consumer good or exempted as a mere instrumentality of an intermediate production stage. The more narrowly the producer's goods exemption is construed, the greater the opportunity for the pyramiding of sales taxes into the final cost of the finished product. At the other extreme, if the producer's goods exemption is interpreted too broadly, the integrity of the tax base is threatened.

In Indiana, as in most states which provide the producer's goods exemption, the statutory language exempts goods used in "direct production."<sup>114</sup> This language has been the subject of differing interpretations since its enactment in 1963. The department historically has sought to dissect the specific parts of the production process, analyze the effect of each item of equipment on the work in process, and allow the exemption only if the effect is "immediate." Based on this analysis, the department has argued that such a relationship exists only when the equipment makes physical contact with the work in process or, by itself, transforms the work during production. Equipment which merely supported the process of production, or which produced effects only indirectly through intermediary equipment or substances, was not granted exemption by the department.<sup>115</sup>

Taxpayers, on the other hand, have urged the department and Indiana courts to interpret the language as providing exemptions for equipment that forms an essential and integral part of an integrated production process. Under this so-called "integrated plant" theory, it is the integrated manufacturing process which causes production to occur, and any item of equipment that is an integral part of the manufacturing process should be exempt from sales and use tax. One of the earliest judicial articulations of the integrated plant theory was made in *Niagara Mohawk Corporation v. Wanamaker*.<sup>116</sup> In its evaluation the court stated

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112. J. DUE AND J. MIKESELL, SALES TAXATION 41 (1983).

113. *Id.* at 50.

114. IND. CODE § 6-2.5-5-3(b) (1988). The term "direct production" has always been an element of the manufacturing exemption in Indiana. See IND. CODE ANN. § 64-2654(b)(6) (Burns Supp. 1964).

115. See *infra* notes 117-62 and accompanying text.

116. 286 App. Div. 446, 144 N.Y.S.2d 458 (1955), *aff'd* 2 N.Y.2d 764, 139 N.E.2d 150, 157 N.Y.S.2d 972 (1956). See also *Duval Sierrita Corp. v. Arizona Dep't of Revenue*,

[i]t is not practical to divide a generating plant into "distinct" stages. It was not built that way, and it does not operate that way. The words "directly and exclusively" should not be construed to require the division into theoretically distinct stages of what is in fact continuous and indivisible.<sup>117</sup>

Because of some early detours in the course of interpreting its exemption statute, Indiana failed to accept the integrated plant doctrine until some twenty years after the enactment of its sales and use tax.

### *B. Administrative and Judicial Interpretation*

In its earliest interpretations contained in administrative circulars,<sup>118</sup> the department sought to limit the exemption to equipment which "acted upon" and had a "positive effect on" the goods under production.<sup>119</sup> Generally, the department required that the specific equipment effect some "transformation" or conversion of the product before exemption would be allowed.<sup>120</sup> The department's first official regulations interpreting the manufacturing exemption, adopted in 1972, followed the restrictive interpretations contained in the earlier circulars.<sup>121</sup>

In a series of cases in the 1970's, the Indiana Courts of Appeals had the opportunity to interpret the manufacturing exemption. Unfortunately, the first decision, *Indiana Department of State Revenue v. RCA Corp.*,<sup>122</sup> started the court down a path that seemed to magnify

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116 Ariz. 200, 568 P.2d 1098 (Ariz. App. 1977); *Arkansas Beverage Co. v. Heath*, 257 Ark. 991, 521 S.W.2d 835 (1975); *Richardson v. State Tax Comm'n*, 100 Idaho 705, 604 P.2d 719 (1979); *Ames v. State Tax Comm'n*, 246 Iowa 1016, 71 N.W.2d 15 (1955); *Ross v. Greene & Webb Lumber Co.*, 567 S.W.2d 302 (Ky. 1978); *Courier Citizen Co. v. Commissioner of Corp. & Taxation*, 358 Mass. 563, 266 N.E.2d 284 (1971); *Floyd Charcoal Co. v. Director of Revenue*, 599 S.W.2d 173 (Mo. 1980); *Manitowoc Co. v. Sturgeon Bay*, 122 Wis. 2d 406, 362 N.W.2d 432 (Wis. Ct. App. 1984).

117. 286 App. Div. at 449, 144 N.Y.S.2d at 461-62.

118. The Indiana Department of Revenue initially issued circular ST-16 on February 3, 1964, describing and defining the tests to be satisfied to exempt certain property from application of sales tax. IND. DEP'T OF REVENUE, CIRCULAR ST-16 (REVISED) (Feb. 3, 1964). A revised, but substantially identical, circular was issued a year later. IND. DEP'T OF REVENUE, CIRCULAR ST-16 (REVISED) (April 5, 1965). In 1967, however, a substantially revised circular was issued, citing several pages of exemption examples that reflected a more liberal scope of exemptions and included previously non-exempt items. IND. DEP'T OF REVENUE, CIRCULAR ST-16 (REVISED) (Jan. 1, 1967). Two years later, the Dept. retreated to its pre-1967 position in its revised Circular ST-16. IND. DEP'T OF REVENUE, CIRCULAR ST-16 (REVISED) (July 1, 1969).

119. IND. DEP'T OF REVENUE, CIRCULAR ST-16 (REVISED) 2 (July 1, 1969).

120. IND. ADMIN. RULES & REGS. 15(IV) (Burns 1976).

121. IND. ADMIN. RULES & REGS. 15 to 17 (Burns 1976).

122. 160 Ind. App. 55, 310 N.E.2d 96 (1974).



the controversy and uncertainty surrounding the exemption and would eventually be rejected fourteen years later. At issue was the status of air conditioning equipment that was used to control the temperature, humidity, and presence of foreign particles in the air and to avoid contamination in the process of manufacturing color television picture tubes. The court observed that the manufacturing exemption contained the requirement that exempt equipment be "'directly used' in the 'direct production' of tangible personal property."<sup>123</sup> It interpreted the reiteration of the "direct" requirement in the phrase "directly used. . . in the direct production"<sup>124</sup> as a sign that the legislature intended the exemption to be narrowly construed and, therefore, required an extremely close connection between the equipment and the items being produced.<sup>125</sup> This "double direct" interpretation was not only logically questionable, it proved to be very difficult to apply in a consistent and common sense fashion, as later cases illustrate.

The problem with the court's analysis was that, by the convenient use of an ellipsis, it omitted the critical phrase "by the purchaser" from the exemption statute. When that phrase is reinserted, it appears that the legislative intent was to insure that the exemption applied to equipment "*directly used by the purchaser*" and not by some other entity.<sup>126</sup> When correctly read in its entirety, the statute requires only that the equipment be used in direct production. There is no second "direct" in the statute relating to the way equipment is used within the production process.

In *Indiana Department of State Revenue v. Indianapolis Transit System, Inc.*,<sup>127</sup> the court of appeals dealt with the "public transportation" exemption.<sup>128</sup> The court acknowledged and apparently accepted the "double directness" interpretation of *RCA* but distinguished it from the instant case on two grounds.<sup>129</sup> The court, however, relied

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123. *Id.* at 56, 310 N.E.2d at 97 (quoting IND. CODE § 6-2-1-39(b)(6) (1971)) (emphasis in original).

124. The statute exempted "[s]ales of manufacturing machinery, tools and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." IND. CODE §6-2-1-39(b)(6) (1971).

125. 160 Ind. App. at 62, 310 N.E.2d at 100.

126. See e.g., *Harold MacQuin, Inc. v. Halperin*, 415 A.2d 818 (Me. 1980) (exemption refused for loaned equipment). See also *Indiana Department of Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983).

127. 171 Ind. App. 299, 356 N.E.2d 1204 (1976).

128. The "public transportation exemption" precludes application of state gross retail tax to "the sale . . . storage, use or other consumption . . . of tangible personal property or service which is directly used or consumed in the hindering of public transportation of persons or property." IND. CODE § 6-2-1-39(b)(4) (1971).

129. 171 Ind. App. at 305-06, 356 N.E.2d at 1208-09.

on *RCA* to afford a broader judicial construction of the "single directness requirement" of this specific exemption and allowed the exemption.<sup>130</sup>

In *State Department of Revenue v. Calcar Quarries, Inc.*,<sup>131</sup> the taxpayer operated a stone quarry, an asphalt plant, and a concrete plant. The trial court found these operations to be integrated.<sup>132</sup> The primary issue was whether trucks and tractors were exempt since they were used to transport stone from the quarry to a crusher, from the crusher to stockpiles, and from the stockpiles to the asphalt or concrete plants. Because the transportation equipment was used as part of this integrated operation, transportation of the stone was held to be exempt.<sup>133</sup> The court found evidence to the contrary and stated that "[t]he concept of an integrated operation makes inappropriate the State's references to 'pre-production' and 'post-production' activities."<sup>134</sup> The most important result of *Calcar* was the recognition of the importance of the equipment's role in an integrated plant or an integrated production process.

Approximately a year after the Indiana First District Court of Appeals' decision in *Calcar*, the second district issued its opinion in *Indiana Department of State Revenue v. Cave Stone, Inc.*,<sup>135</sup> a case involving similar facts. Cave Stone's operation included removing crude stone from quarries, transporting it to crushers, crushing and screening stone into grades of aggregate, and ultimately hauling this stone to various stock piles.<sup>136</sup> Without referring to *Calcar*, the court held that equipment used to transport stone from a quarry to a crusher and then to stockpiles was taxable because it was not "directly used in the direct mining and processing of the stone."<sup>137</sup> Thus, the Indiana Second District Court of Appeals accepted the department's ultimate audit and litigating position: the effect of equipment on work in process had to be considered separately from all other equipment used in production. Each item would be exempt only if its effect, disregarding its role in the overall production process, caused some transformation or change in the product undergoing processing. The production process itself had to be fractured into many individual parts, as if a production plant consisted of various separately identifiable production processes.

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130. *Id.* at 306, 356 N.E.2d at 1208.

131. 182 Ind. App. 84, 394 N.E.2d 939 (1979).

132. *Id.* at 89, 394 N.E.2d at 942.

133. *Id.* at 90, 394 N.E.2d at 943.

134. *Id.*

135. 409 N.E.2d 690 (Ind. Ct. App. 1980), *rev'd*, 457 N.E.2d 520 (Ind. 1983).

136. *Id.* at 692.

137. *Id.* at 696.



The relationship between each item of production equipment and the work in process was analyzed. Only those which were so closely connected with work in process that they physically transformed the product would qualify.<sup>138</sup> In a strong dissent, Chief Judge Buchanan refused to accept the line-drawing approach of the department and the majority and endorsed the integrated plant theory.<sup>139</sup>

On transfer, the majority opinion of the court of appeals was reversed.<sup>140</sup> The Indiana Supreme Court agreed with the dissent of Chief Judge Buchanan, stating that "[t]he issue, then, is whether the transportation is an integral part of the production or processing of the stone."<sup>141</sup> Finding that the equipment was both necessary to the production of the finished product and an integral part in the ongoing process of processing the stone into a finished product,<sup>142</sup> the court rejected the overly narrow analysis of the second district and approved the analysis of the first district in *Calcar*.<sup>143</sup>

Despite the judicial setback to its litigating position,<sup>144</sup> the department continued to hold fast to its restrictive interpretation. In its administrative rulings during the post-*Cave Stone* period, the department found the following to be taxable: electrical distribution systems located beyond the final control switch of certain equipment;<sup>145</sup> air compressors used to drive production machinery;<sup>146</sup> coolant and lubricating fluid circulation systems;<sup>147</sup> gloves necessary to avoid burns and cuts;<sup>148</sup> quality control equipment located away from the immediate production area;<sup>149</sup> scales used to weigh raw materials;<sup>150</sup> and work benches.<sup>151</sup> The inconsistency between the *Cave Stone* formulation of the test for ex-

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138. *Id.* at 695-97.

139. *Id.* at 698-99 (Buchanan, C.J., dissenting).

140. *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520 (Ind. 1983).

141. *Id.* at 524.

142. *Id.*

143. *Id.* at 525. The Court concluded that the first district, in *Calcar*, strictly construed the statute and that the court of appeals in the instant case "took such strict construction one step further and narrowed it to a breadth that we cannot accept." *Id.*

144. In the interim between the two *Cave Stone* decisions, the Fourth District Court of Appeals in *Department of Revenue v. United States Steel Corp.*, 425 N.E.2d 659 (Ind. Ct. App. 1981), expressly rejected the "positive effect" and "causal relationship" test of the Department's regulations in upholding the exemption for safety equipment.

145. Rev. Rul. 83-5988-ST (1984), 8 Ind. Reg. 949 (1985).

146. Rev. Rul. 84-6671-ST (1984), 8 Ind. Reg. 950 (1985).

147. Rev. Rul. 84-6953-ST (1985), 10 Ind. Reg. 960 (1987).

148. Rev. Rul. 83-6091-ST (1984), 8 Ind. Reg. 944 (1985).

149. Rev. Rul. 83-6091-ST (1984), 8 Ind. Reg. 945 (1985).

150. Rev. Rul. 83-5899-ST (1984), 8 Ind. Reg. 947 (1985).

151. Rev. Rul. 83-6091-ST (1984), 8 Ind. Reg. 944 (1985).

emption and the department's administrative position ensured that conflict would continue. Three more decisions by the Indiana Court of Appeals in a four-year span resolved this conflict against the department.

In *Indiana Department of State Revenue v. Indiana Harbor Belt Railroad Co.*,<sup>152</sup> the court of appeals found that the *Cave Stone* analysis could be applied by analogy to the scope of the exemption for equipment used in public transportation, even though the public transportation exemption used the word "direct" only once instead of twice as in the case of the manufacturing exemption.<sup>153</sup> The court cited the *Cave Stone* concept "of direct use or consumption in the integrated operation of providing public transportation"<sup>154</sup> to affirm the trial court's finding that certain items were exempt even without a specific finding that these items were "directly" used or consumed in the provision of public transportation services.<sup>155</sup>

Another case required the court to determine whether haulage rock and haulage road graders were an integral part of production or processing of a coal mining operation. In *Indiana Department of State Revenue v. AMAX, Inc.*,<sup>156</sup> the Indiana First District Court of Appeals found that since the rock and road graders were essential to the building and maintenance of haulage roads, without which marketable coal could not be produced from AMAX's surface mines,<sup>157</sup> they were "directly used or consumed by AMAX in the direct production of personal property so as to be exempt."<sup>158</sup>

Most recently, the court decided *Department of Revenue v. Kimball International, Inc.*,<sup>159</sup> in which spray booths and air make up units used in a wood finishing plant were held to be exempt. The disputed items were necessary to create a suitable environment for the application of a finish to the products.<sup>160</sup> The court finally recognized that the Department's narrow reading of *RCA* could not be squared with *Cave Stone*,<sup>161</sup> and that the former should essentially be confined to its specific facts:

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152. 460 N.E.2d 170 (Ind. Ct. App. 1984).

153. *Id.* at 175.

154. *Id.* at 176.

155. *Id.* at 175.

156. 513 N.E.2d 1260 (Ind. Ct. App. 1987).

157. *Id.* at 1261. The haul roads would lengthen as the open pit coal mine walls would recede from the coal processing plant. The heavy traffic of coal transport trucks required constant maintenance of the haul roads.

158. *Id.* at 1263. The court relied on the *Cave Stone* analysis to reach its conclusion.

159. 520 N.E.2d 454 (Ind. Ct. App. 1988).

160. *Id.* at 455.

161. The court found that the department had interpreted *RCA* to "support the proposition that environmental control equipment is never exempt . . . and that exempt equipment must have a positive effect on the product." *Id.* at 456.



The Department also finds in *RCA* a requirement that to be exempt equipment must have a positive effect on the product. This is clearly inconsistent with the Supreme Court's holding that the focus is on the whole process, and that the product does not have to be transformed by the equipment in question. . . . Accordingly, it is necessary to make clear that [to] the extent that it stands for any point inconsistent with the controlling precedent of *Cave Stone, supra*, then *Ind. Dept. Rev. v. RCA, supra*, is hereby expressly overruled.<sup>162</sup>

### C. The New Regulations

On April 1, 1987, the department proposed new regulations,<sup>163</sup> which were published as final rules on September 1, 1987.<sup>164</sup> The new regulations closely track the *Cave Stone* decision. The most important change is the department's adoption of the integrated plant theory:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. *Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.*<sup>165</sup>

An identical test is applied to determine exemptions for agriculture,<sup>166</sup> mining and extraction,<sup>167</sup> processing or refining,<sup>168</sup> production of manufacturing or agricultural equipment,<sup>169</sup> and for property consumed in production process or mining,<sup>170</sup> or consumed in agriculture.<sup>171</sup>

The regulations contain numerous examples apparently designed to reverse prior rulings. For example, the following items are specifically identified as exempt:

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162. *Id.* at 456-57 (emphasis in original).

163. 10 Ind. Reg. 1396 (1987).

164. 10 Ind. Reg. 2610 (1987) (codified at IND. ADMIN. CODE tit. 45, r. 2.2-5-1 to r. 2.2-5-70 (1988)).

165. IND. ADMIN. CODE tit. 45, r. 2.2-5-8(c) (1988) (emphasis added).

166. *Id.* r. 2.2-5-1(a).

167. *Id.* r. 2.2-5-9(c).

168. *Id.* r. 2.2-5-10(c).

169. *Id.* r. 2.2-5-11(c).

170. *Id.* r. 2.2-5-12(c).

171. *Id.* r. 2.2-5-13(b).

- “[a]ir compressors used as a power source for exempt tools and machinery;”<sup>172</sup>
- “[e]lectrical distribution system, including generators, transformers, electrical switchgear, cables inside or outside the plant, and related equipment used to produce and/or supply electricity to exempt manufacturing equipment;”<sup>173</sup>
- “[a] workbench used in conjunction with a work station or which supports production machinery;”<sup>174</sup>
- “[s]afety clothing or equipment which is required to allow a worker to participate in the production process;”<sup>175</sup>
- “[a]n automated scale process which measures quantities of raw aluminum for use in the next production step of the casting process in the foundry;”<sup>176</sup>
- “[p]umping and filtering equipment and related tanks and tubing used to supply lubricating and coolant fluids to exempt drilling and cutting machinery.”<sup>177</sup>

This short list of examples demonstrates the fundamental change wrought by the new regulations. None of the former cited equipment would have been exempt under the former “positive effect” and “causal relationship” interpretation urged by the department in prior years.

With the adoption of the new regulations, Indiana has joined the majority of states in accepting the “integrated plant” doctrine as the controlling principle under which the manufacturing exemption will be construed. While the new test will not resolve all potential issues which may arise from the myriad variations of the production process, it at least provides a sound conceptual basis upon which controversies will be decided.

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172. *Id.* r. 2.2-5-8(c)(2)(A). *Cf.* Rev. Rul. 84-6671-ST (1984), 8 Ind. Reg. 950 (1985) (“The air compressor does not directly, immediately effect the product, but directly, immediately effects [sic] air and production machines.”).

173. IND. ADMIN. CODE tit. 45, r. 2.2-5-8(c)(7)(B) (1988). *Cf.* Rev. Rul. 83-5988-ST (1984), 8 Ind. Reg. 949-50 (1985) (all electrical equipment existing before the final control switch of an exempt machine is taxable).

174. IND. ADMIN. CODE tit. 45, r. 2.2-5-8(c)(2)(E) (1988). *Cf.* Rev. Rul. 83-6091-ST (1984), 8 Ind. Reg. 944 (1984) (work benches taxable).

175. IND. ADMIN. CODE tit. 45, r. 2.2-5-8(c)(2)(F) (1988). *Cf.* Rev. Rul. 83-6091-ST (1984), 8 Ind. Reg. 944 (1985) (work gloves necessary to avoid burns and cuts are not exempt).

176. IND. ADMIN. CODE tit. 45, r. 2.2-5-8(c)(2)(G) (1988). *Cf.* Rev. Rul. 83-5899-ST (1984), 8 Ind. Reg. 947 (1985) (weighing is a pre-production activity and, therefore, taxable).

177. IND. ADMIN. CODE tit. 45, r. 2.2-5-8(c)(3)(A) (1988). *Cf.* Rev. Rul. 84-6953-ST (1985), 10 Ind. Reg. 960 (1987) (such items are taxable as not having a direct effect on product).



#### IV. DEATH TAXES: THE PEARSON CASE

A review of recent developments affecting Indiana tax policy would be incomplete without addressing the issue of death taxes. Prior to an analysis of *Indiana Department of State Revenue v. Estate of Pearson*,<sup>178</sup> and overview of the statutory scheme of Indiana's inheritance and estate taxes is essential. Although the court of appeals decided *Pearson* in 1986, the Indiana Supreme Court adopted and affirmed that decision in April 1988.<sup>179</sup>

##### A. Indiana's Statutory Scheme

Indiana imposes death taxes in two levels.<sup>180</sup> The inheritance tax is a first level tax imposed on transfers of property interests made by a decedent at the time of his death.<sup>181</sup> The inheritance tax on resident decedents is based on Indiana real property, personal property not having an out-of-state situs, and all intangible property owned by the decedent.<sup>182</sup> A nonresident decedent is taxed only on his Indiana real estate and personal property with an Indiana situs.<sup>183</sup> The inheritance tax is imposed at graduated rates based on the amount of property transferred and the classification of the recipient.<sup>184</sup> This tax applies to all death transfers of persons either residing or having property in Indiana.<sup>185</sup> It has no connection with the federal estate tax.

In contrast to the inheritance tax, the Indiana estate tax is directly based on provisions of federal estate tax law.<sup>186</sup> It is a second level tax designed to "pick up" unused portions of the federal death tax credit.<sup>187</sup>

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178. 498 N.E.2d 990 (Ind. Ct. App. 1986).

179. 521 N.E.2d 350 (Ind. 1988), *adopting and aff'g* 498 N.E.2d 990 (Ind. Ct. App. 1986).

180. "State death taxes" refers to all taxes imposed by a state upon death transfers regardless of the measure of the tax or the subject upon which it is imposed. "Inheritance tax" refers to a state tax imposed upon an heir for the privilege of receiving property from a decedent. "Estate tax" refers to a tax, whether state or federal, imposed upon a decedent's estate for the privilege of making death transfers. A "first" or "second level" tax refers to death taxes of a state that imposes both an inheritance (first-level) tax on all estate and an estate (second-level) tax on estates of a certain magnitude.

181. IND. CODE § 6-4.1-2-1(a) (1988). The inheritance tax is assessed upon the property which is transferred by the decedent and is to be paid by the estate's personal representative prior to distribution. *Id.* §§ 6-4.1-8-1, -2.

182. *Id.* § 6-4.1-2-2.

183. *Id.* § 6-4.1-2-3.

184. *Id.* § 6-4.1-5-1.

185. *Id.* § 6-4.1-2-1.

186. *Id.* §§ 6-4.1-11-1 to -6.

187. In this article, the term "pickup tax" is used to refer to a state death tax

The Indiana estate tax for resident decedents is computed by reducing the federal death tax credit by the total state death taxes paid by the estate. The remainder is then assessed as the estate tax.<sup>188</sup> For nonresidents, the amount of the federal death tax credit is also reduced by total state death taxes. The remainder is then multiplied by a fraction representing the percentage of the total federal gross estate located in Indiana.<sup>189</sup> In determining the actual death taxes paid for purposes of reducing the federal death tax credit, the term "state death tax" does not include the Indiana estate tax "or any tax which is similar in purpose and character to the Indiana estate tax."<sup>190</sup>

### *B. The Pearson Case: Background and Issue*

In *Pearson*, the decedent was an Indiana resident with property in both Indiana and Florida. His estate was subject to the federal estate tax and was entitled to a federal death tax credit of \$14,632.02. His estate paid an Indiana inheritance tax of \$7,052.55 and a Florida death tax of \$1,311.81.<sup>191</sup> The sole issue was whether the Florida tax was "similar in purpose and character to the Indiana estate tax" and, therefore, nondeductible in computing the Indiana estate tax.<sup>192</sup>

Florida imposes a single death tax, which is the product of the federal death tax credit and a fraction representing the portion of a decedent's total estate located in Florida.<sup>193</sup>

### *C. The Court of Appeals' Opinion*

As a threshold matter, the court of appeals determined that its construction of Indiana Code section 6-4.1-1-12, specifically the words "similar in purpose and character," should be based upon prior in-

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measured by reference to the federal death tax credit. The "federal death tax credit" refers to the credit against a decedent's federal estate tax for state death taxes. I.R.C. §§ 2011, 2102 (1986) provide a credit against the federal estate tax for state death taxes that is not to exceed a certain scheduled amount. Unless the decedent actually pays the state death taxes, there is no credit. This provides an incentive for states to impose "pickup" taxes, which effectively transfer funds from federal to state coffers without increasing the tax burdens of individual decedents. Note that pickup taxes do not apply to persons whose taxable estates are not subject to the federal estate tax (generally estates below \$600,000 under current law).

188. IND. CODE § 6-4.1-11-2(a) (1988).

189. *Id.* § 6-4.1-11-2(b).

190. *Id.* § 6-4.1-1-12.

191. 498 N.E.2d 990 (Ind. Ct. App. 1986).

192. *Id.* at 990. *See* IND. CODE § 6-4.1-1-12 (1988). In this case the actual tax in controversy was \$1,311.81, the Florida tax.

193. *Id.* at 992. Relevant portions of Florida Statutes section 198.03 are quoted in the court's opinion.



terpretation of the predecessor statute.<sup>194</sup> The only appellate opinion addressing the prior statute was *State v. Purdue National Bank*.<sup>195</sup> The court relied on the factual similarity of *Purdue National Bank* and its holding that "pickup taxes paid other states are not to be subtracted when computing the Indiana estate tax"<sup>196</sup> to dismiss the estate's argument that the *Purdue National Bank* holding was limited to the second level pickup taxes of Tennessee and Kentucky, and therefore not applicable to the single Florida tax.<sup>197</sup> The *Pearson* court seized upon the following language in *Purdue National Bank*: "'It is our opinion that pickup taxes paid other states are not to be deducted when computing the pickup tax imposed by paragraph (a) of the above statute [I.C.6-4-1-37].'"<sup>198</sup>

The court concluded that the Florida tax was a pickup tax and, solely because of that label, was "similar in character and purpose" to the Indiana estate tax.<sup>199</sup> It found further that the essential character of a pickup tax was *not* its second level nature nor its subject but

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194. *Id.* at 991-92. In 1976, the Indiana General Assembly recodified the Indiana inheritance tax and estate tax laws. Act approved February 18, 1976, Pub. L. No. 18, 1976 Ind. Acts 69. Section 6-4.1-1-12 was the successor statute to prior IND. CODE § 6-4-1-37 (1971) which provided:

(a) In the event that a federal estate tax is payable to the United States on the estate of a decedent who was a resident of the state of Indiana at the time of his death and the inheritance tax, if any, paid to the state of Indiana, disregarding interest, plus the death taxes (not including any credit for state death taxes allowed by the federal estate tax law) paid to other states or territories in respect to the property of the decedent is less than the maximum credit for state taxes allowed by the federal estate tax law, a tax equal to such difference is hereby imposed.

(b) A tax is levied against the estate of every decedent not domiciled in this state upon the transfer of the portion of the decedent's gross estate in the state of Indiana equal in amount to that proportion of the amount by which the death tax credit exceeds the amount of state death taxes, exclusive of taxes imposed by other states of the character and purpose of the tax levied by paragraph (a) of this section which the value of the portion of the decedent's gross estate in the state of Indiana bears [to] the value of decedent's entire gross estate.

IND. CODE § 6-4-1-37 (1971).

195. 171 Ind. App. 76, 355 N.E.2d 414 (1976).

196. 498 N.E.2d 990, 991 (Ind. Ct. App. 1986).

197. *Id.*

198. *Id.* (quoting *Purdue National Bank*, 171 Ind. App. at 78, 355 N.E.2d at 416). In *Purdue National Bank*, the meaning of the parenthetical words, "not including any credit for state death taxes allowed by the federal estate tax law," was construed to refer to pickup taxes, defined as "additional tax[es] in an amount equal to the amount by which the allowed credit exceeds the state tax." 171 Ind. App. at 76, 77 n.1, 355 N.E.2d at 415 n.1.

199. 498 N.E.2d at 994.

rather its nature as "a tax levied by the state in order to take advantage of the federal death tax credit."<sup>200</sup>

The court then addressed the estate's argument that the taxes were not similar in nature because the Florida tax was assessed solely on the property located in Florida, while Indiana's estate tax was not so limited. This was dismissed as merely a jurisdictional requirement rather than a distinction in purpose or character.<sup>201</sup> The estate also argued that the Florida tax scheme prevented total death taxes from exceeding the federal death tax credit. Even if this was so, the court responded, it has nothing to do with the purpose and character of the tax.<sup>202</sup> The court also dismissed various other arguments advanced by the estate for the reason that they did not specifically demonstrate that the purpose and character of the two taxes were different.<sup>203</sup> Specifically the court found:

All of the distinctions which the Estate would draw are distinctions collateral to the essential purpose and character of the taxes themselves. Both taxes are, undeniably, pickup taxes. The purpose of both the Florida estate tax and the Indiana estate tax is to take advantage of the federal estate tax credit for state death taxes paid.<sup>204</sup>

To portray the essential similarity of the character of the two taxes, the court then set out the mathematical formulas for computing Indiana and Florida estate taxes:

$$\text{Indiana Estate Tax} = \frac{\text{Indiana Estate}}{\text{Gross Estate}} \times (\text{Federal tax credit} - \text{State death taxes})$$

$$\text{Florida Estate Tax} = \frac{\text{Florida Estate}}{\text{Gross Estate}} \times \text{Federal tax credit.}^{205}$$

200. *Id.* at 991 (citing 42 AM. JUR. 2D *Inheritance, Estate, and Gift Taxes* § 7 (1969)).

201. *Id.* at 992. The court also noted that if a reference to property within the taxing state is sufficient to render another state's death tax different in purpose and character, no tax levied by another state would be excluded by IND. CODE § 6-4.1-1-12 (1988), and the statute would be superfluous. *Id.*

202. *Id.* at 993.

203. *Id.* The arguments were that the Florida tax did not reduce its tax base by other states' death taxes while Indiana did and that Indiana had a two level inheritance-estate tax while Florida imposed but a single death tax.

204. *Id.*

205. *Id.* at 994.



The court further noted:

The similarity in character between the two taxes is demonstrated by the means each tax employs to achieve its purpose. Both taxes refer to the federal tax credit in order to determine the estate tax owed. In fact, the only difference between the formula employed by Indiana to determine the estate tax of a non-resident decedent and the formula used by Florida is that the Indiana formula takes into account the state death taxes paid.<sup>206</sup>

D. Analysis

The court of appeals' opinion correctly identified the purpose of pickup taxes as diverting funds to state treasuries which otherwise would be destined for federal use.<sup>207</sup> However, the sketchy analysis by the court of the *character* of the two taxes missed the point.

As a general rule, the character of a tax must be determined by reference to its classification, its subject, and its measure.<sup>208</sup> Death taxes are classified as excise taxes; that is, taxes imposed on the exercise of a specific right in property.<sup>209</sup> The subject of a death tax is either the privilege of inheriting property (inheritance tax) or the privilege of transferring property at death (estate tax). The measure is the method used to determine the tax due. For inheritance taxes, the measure is generally a progressive rate structure; for estate taxes, the measure is generally a portion or the whole of the federal death tax credit.

Prior to determining whether another state's death tax is similar in character to the Indiana estate tax, a determination of the character of the Indiana tax is necessary. Indiana's estate tax imposed on resident decedents differs from that imposed on nonresidents.<sup>210</sup>

Resident Estate Tax = Federal Death Tax Credit - State Death Taxes  
Actually Paid <sup>211</sup>

Nonresident Estate Tax =  $\frac{\text{Indiana Estate}}{\text{Gross Estate}}$  x  $\frac{\text{Federal Death Tax Credit}}{\text{Actually Paid}}$  - State Death Taxes <sup>212</sup>

206. *Id.* at 993-94.  
207. *See* Estate of Fasken, 19 Cal.3d 412, 417-20, 563 P.2d 832, 834-36, 138 Cal. Rptr. 276, 278-80 (1977) for a cogent history and analysis of the purpose of a pickup tax.  
208. J. HELLERSTEIN & W. HELLERSTEIN, STATE AND LOCAL TAXATION 27 (1978); *see generally* 71 AM. JUR. 2D *State and Local Taxation* § 22 (1973).  
209. J. HELLERSTEIN & W. HELLERSTEIN, *supra* note 208, at 29.  
210. *Compare* IND. CODE §6-4.1-11-2(a) (1988) *with id.* §6-4.1-11-2(b).  
211. *Id.* § 6-4.1-11-2(a).  
212. *Id.* § 6-4.1-11-2(b).

The character of the resident estate tax is that of an excise on the death transfer of a decedent's total estate, measured by the *total* federal death tax credit reduced by death taxes paid to all states.<sup>213</sup> This measure will be referred to as the "excess federal death tax credit."<sup>214</sup>

The character of Indiana's nonresident estate tax, on the other hand, is that of an excise on the death transfer of a decedent's apportioned estate, measured by the *apportioned* excess federal death tax credit. The excess federal death tax credit is apportioned by Indiana, which asserts a claim to only that portion of the excess federal death tax credit which is proportionate to the size of the decedent's Indiana estate.<sup>215</sup>

Although the taxes on residents and nonresidents are excise taxes on death transfers, it is readily apparent that the taxes differ in both the property that is being taxed and in the measure of the tax. Indiana asserts entitlement to the entire excess federal death tax credit of its resident decedents, and it asserts a proportionate entitlement to the excess federal death tax credit of nonresident decedents.<sup>216</sup> Each of these taxes must be regarded separately. Because they tax different interests and use different measures, they must be regarded as having distinctly different characters.

The next question is the meaning of Indiana's exclusion from the computation of the excess federal death tax credit of state death taxes "similar in purpose and *character* to the Indiana estate tax."<sup>217</sup> Which of Indiana's estate taxes—resident or nonresident—is referred to by this statutory command? It is clear from prior law that the reference is to the resident estate tax.<sup>218</sup> In the former statute imposing the nonresident

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213. At this point in the analysis, it is not important to determine whether another state's death tax should be subtracted from the federal death tax credit. The crucial fact to be recognized is that the measure of the tax on Indiana residents is the entire federal death tax credit, unapportioned by the location of the estate's property.

214. The amount of the excess federal death tax credit will vary according to the death tax rates imposed by states in which the decedent's property is located. As a practical matter, most states imposing inheritance taxes will not entirely utilize their proportionate share of the estate death tax credit.

215. The constitutional difficulties inherent in such an apportionment are addressed *infra* at text accompanying notes 224-39.

216. IND. CODE § 6-4.1-11-2(a), (b) (1988). From a federal point of view, such a position is indefensible. For example, if each state asserted such a right, all decedents having property in more than one state would be subjected to multiple taxation in the name of picking up the estate death tax credit. For example, a decedent having an estate death tax credit of \$100,000 with property equally divided between States A and B would be assessed taxes by State A (his state of residence) in the amount of \$100,000 and by State B in the amount of \$50,000 (assuming no inheritance or first level taxes).

217. IND. CODE § 6-4.1-1-12 (1988) (emphasis added).

218. *Id.* § 6-4-1-37 (1971) (repealed 1976). Subsections from this section of the statute are quoted *supra* note 194.



estate tax, the legislature provided for an apportioned tax on the excess estate death tax credit "exclusive of taxes imposed by other states of *the character and purpose* of the tax levied by paragraph (a) of this section."<sup>219</sup> Paragraph (a) describes the resident estate tax and includes the words interpreted by *Purdue National Bank* as referring to state pickup taxes.<sup>220</sup> Because the current statutes are merely a "codification or restatement of applicable or corresponding provisions" of prior law,<sup>221</sup> the proper test in determining whether a state's death taxes should reduce the federal death tax credit is whether the questioned tax is similar in purpose and character to Indiana's estate tax imposed upon *resident* decedent's estates, that is, a pickup tax arrogating to the taxing state *all* of the excess federal death tax credit, regardless of the location of the estate's property.

The court of appeals' comparison of the Florida estate tax with the Indiana estate tax for *nonresident* decedents to demonstrate the similar character of the two taxes was erroneous.<sup>222</sup> The proper test is to compare the Indiana resident tax, which imposes a tax on the total death transfers of a decedent, with the Florida estate tax, which imposes a tax on only the portion of the decedent's estate apportioned to Florida. The result of such a test should be a determination that the Florida tax is not similar in character to the Indiana tax and, therefore, the federal death tax credit should be reduced by the Florida tax prior to the calculation of the Indiana tax. The result of such a determination would have been the allocation of the federal death tax credit between Indiana and Florida according to each state's respective portion of Pearson's estate.

This interpretation of the statute would require Indiana to disregard only those state death taxes which, like Indiana's resident estate tax, assert entitlement to the full unapportioned federal death tax credit.<sup>223</sup> This would permit Indiana to collect its estate tax despite the heavy-handedness of other states' legislatures, but would require it to respect other states' claims to a proportionate amount of the federal death tax credit.

#### *E. The Constitutionality of Indiana's Estate Tax As Construed in Pearson*

Neither the court of appeals nor the supreme court in affirming *Pearson* addressed the constitutionality of the Indiana estate tax.<sup>224</sup> For

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219. IND. CODE § 6-4-1-37(b) (1971) (repealed 1976) (emphasis added).

220. See *supra* text accompanying notes 199-200.

221. Act approved February 18, 1976, Pub. L. No. 18, § 3, 1976 Ind. Acts. 69, 104.

222. See *supra* text accompanying note 206.

223. See *supra* text accompanying note 188.

224. 498 N.E.2d 990 (Ind. Ct. App. 1986), *adopted and aff'd*, 521 N.E.2d 350 (Ind. 1988).

several reasons, the tax as construed in *Pearson* may be constitutionally defective.

The source of the potential defect is that the estate tax imposes a direct tax on tangible property located out of state. It does this by asserting an entitlement to the excess federal death tax credit, which, in the case of estates with multi-jurisdictional property, must be based upon property located in another state. This concept can best be illustrated by the following examples:

*Example 1:* A died a resident of Indiana leaving an estate equally divided between Indiana and State X. A's estate has a federal death tax credit of \$100,000. Indiana levies an inheritance tax of \$25,000. State X levies an inheritance tax of \$20,000. Indiana then assesses an estate tax of \$55,000, computed as follows:

Federal death tax credit	\$100,000
less state death taxes	
(\$25,000 + \$20,000)	(45,000)
Indiana resident estate tax	\$ 55,000

In this example, Indiana would collect a total of \$80,000 in death taxes. The \$25,000 inheritance tax is clearly imposed with reference to Indiana property. The pickup tax, on the other hand, is measured by the total federal death tax credit, which is computed under federal law with reference to the total estate located both in Indiana and in State X.<sup>225</sup>

In *Frick v. Pennsylvania*,<sup>226</sup> the United States Supreme Court declared unconstitutional a state death tax imposed upon out-of-state tangible property. The court stated that "[w]hile a State may so shape its tax laws as to reach every object which is under its jurisdiction it cannot give them any extraterritorial operation."<sup>227</sup>

The Court reached the same decision in *Treichler v. Wisconsin*.<sup>228</sup> In *Treichler*, Wisconsin had a pickup tax virtually indistinguishable from that of Indiana.<sup>229</sup> However, what was at issue was the constitutionality of the statutorily imposed, third-level emergency excise of 30% of the total Wisconsin death taxes.<sup>230</sup> The *Treichler* Court did not specifically address the constitutionality of the pickup tax, but instead examined whether the tax, to the extent it was measured by tangible property

225. I.R.C. §§ 2031, 2103 (1986).

226. 268 U.S. 473 (1925).

227. *Id.* at 489.

228. 338 U.S. 251 (1949).

229. WIS. STAT. § 72.50 (1947) (repealed and recreated at WIS. STAT. § 72.61 (1988)).

230. WIS. STAT. § 72.74(2) (1947) (repealed and recreated at WIS. STAT. § 72.18 (1988)).



located outside of Wisconsin, was in violation of the Due Process Clause of the fourteenth amendment.<sup>231</sup> The Court first noted that Wisconsin claimed the entire excess federal death tax credit without apportionment according to the location of the estate's property. The deduction allowed for other states' death taxes did not effect an apportionment because those taxes "have no necessary relation to the proportion of property outside Wisconsin."<sup>232</sup> Therefore, because the second local pickup tax was "a tax on property rated and measured in part by tangible property, the situs of which was outside Wisconsin," the tax was an unconstitutional deprivation of property without due process.<sup>233</sup>

*Treichler* was cited by the California Supreme Court in its decision that a California tax regulation was unconstitutional. In *Estate of Fasken*,<sup>234</sup> *Treichler* was interpreted to mean "that because the federal credit for state death taxes is 'rated and measured by the entire estate, regardless of situs,' no state can assert a claim to *all* of that credit when some taxable portion of the estate is located in another state."<sup>235</sup>

The regulation declared unconstitutional in *Fasken* was somewhat less intrusive than the tax imposed by Indiana on its residents. The regulation required California taxing authorities to compute the pickup tax for decedents' estates with property both in California and other states (regardless of the decedent's residence) by multiplying the excess federal death tax credit by a fraction representing the California portion of the estate.<sup>236</sup> In essence, this regulation adopted for both residents and nonresidents a pickup tax computation identical to that imposed upon nonresidents by Indiana.<sup>237</sup> This type of tax was held to be unconstitutional by the California court:

[T]he allowable pick-up tax which may be levied by one state in a situation where there is multi-state property in a decedent's estate, is not dependent upon the death taxes levied by another state exercising jurisdiction over any of the property involved. Each state according to the *Treichler* formula may properly levy a pick-up tax which is calculated by first apportioning the federal state death tax credit according to the ratio of property which lies within its borders, and then reducing that apportioned credit

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231. 338 U.S. at 256.

232. 338 U.S. at 255.

233. *Id.* (citing *Frick v. Pennsylvania*, 268 U.S. 473 (1925)).

234. 19 Cal. 3d 412, 563 P.2d 832, 138 Cal. Rptr. 276 (1977).

235. *Id.* at 424, 563 P.2d at 839, 138 Cal. Rptr. at 283 (quoting *Treichler v. Wisconsin*, 338 U.S. 251, 254 (1949) (emphasis in original)).

236. *Id.* at 416 n.1, 563 P.2d at 833 n.1, 138 Cal. Rptr. at 277 n.1.

237. See IND. CODE § 6-4.1-11-2(1) (1988).

by its inheritance tax. The balance of the apportioned credit constitutes the pick-up tax.<sup>238</sup>

The defect in the California regulation was that it could result in a tax on the death transfer of property in another state, despite its allocation of the excess federal death tax credit according to location of the estate's property. For example, if the estate was divided equally between California and Arizona and Arizona had no inheritance tax, the regulation would permit California to claim both its inheritance tax and half of the remaining federal death tax credit. This increased California's share of the federal death tax credit beyond the permissible constitutional limits.

Indiana's nonresident pickup tax is indistinguishable from that declared unconstitutional in *Fasken*. The resident pickup tax is even more apparent in its taxation of property located in other states. *Treichler* flatly prohibits such exactions. A pickup tax should have no reference to other states' death taxes. The federal death tax credit should be proportionately allocated to the states in which the estate's property is located. Then each state may levy a pickup tax on its allocated portion of the credit as exceeds its inheritance or other first-level tax—if any.

*Example 2:* An Indiana resident decedent's estate is entitled to a federal death tax credit of \$100,000. His property is evenly divided between Indiana and State X. Indiana imposed inheritance taxes of \$25,000 and State X imposed inheritance taxes of \$15,000.

In *Example 2*, Indiana can impose a tax on property located in Indiana. Because the federal death tax credit is calculated by reference to the decedent's *total* estate, only half of which is in Indiana, the maximum pickup tax would be \$50,000 (50% of the federal death tax credit of \$100,000). Because Indiana has already collected \$25,000 of inheritance tax, the estate tax should properly be \$25,000 (\$50,000 - \$25,000). The formula for such a tax would be as follows:

$$\text{Indiana Pickup Tax} = \frac{\text{Indiana estate}}{\text{Total estate}} \times \text{Federal state death tax credit} - \text{Indiana inheritance tax}$$

This formula should not, and constitutionally cannot, vary between resident and nonresidents.<sup>239</sup>

238. 19 Cal. 3d at 428, 563 P.2d at 841-42, 138 Cal. Rptr. at 285-86.

239. As this Article goes to press, House Bill 1654, providing for a single estate tax applicable to both residents and nonresidents and using this formula, has been introduced in the General Assembly.



### *F. Policy and The Pearson Rule*

Even if the Indiana estate tax suffered no constitutional defect, the policy implications of *Pearson* cry out for legislative amendment. The court stated:

We acknowledge that the imposition of state death taxes in excess of the federal tax credit undermines the policy supporting a state pickup tax. However, as the *Purdue* court noted, such a result is not necessarily outside the intent of the legislature. Absent some clear mandate from the state or federal legislatures, we cannot say that the imposition of these taxes in excess of the federal credit is prohibited.<sup>240</sup>

The potential effect of the estate tax as construed in *Pearson* is to drive taxpayers from Indiana. The type of taxpayer who is adversely affected by the estate tax (a person subject to federal estate taxation, which begins actually to tax estates aggregating in excess of \$600,000) is precisely the type of person most likely to have substantial amounts of property in Florida or other states. The impact of Indiana death taxes may be a component in estate planning, including the selection of domicile. Depending upon the class of beneficiaries<sup>241</sup> and the proportion and type of assets located outside of Indiana, Indiana residents could save substantial death taxes simply by altering their domiciles to another state. Such a change in domicile may be costly to Indiana because of lost income tax revenue, but it relieves the expatriate of the inheritance taxation of his intangible assets and the unapportioned pickup tax imposed by Indiana on its residents. For Mr. Pearson, the cost was only \$1,311.81; for many other persons the cost may prove to be substantially greater.

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240. 498 N.E.2d 990, 994 (Ind. Ct. App. 1986), *adopted and aff'd*, 521 N.E.2d 350 (Ind. 1988) (citation omitted).

241. There is no federal estate tax assessed upon transfers to a person's spouse. I. R. C. § 2056 (1986). Such transfers are also exempt from Indiana's Inheritance tax. IND. CODE § 6-4.1-3-7 (1988). The policy problem raised by the Indiana estate tax typically arises upon the death of a widow or widower.

# The Dram Shop: Closing Pandora's Box

WILLIAM HURST\*

## I. HISTORICAL BACKGROUND

The "dram shop"<sup>1</sup> has been condemned since the time of Babylon<sup>2</sup> as an unequaled source of "crime and misery to society."<sup>3</sup> The over-indulgence occurring in saloons has long been considered a subject for moral and legal condemnation.<sup>4</sup> The preamble of the British Statutes of 1552<sup>5</sup> stated that the "intolerable hurts and troubles to the commonwealth of this realm doth daily grow and increase through such abuses and disorders as are had and used in common ale-houses and . . . tippling-houses."<sup>6</sup>

From early English legislation to the present time, statutes in various forms have been enacted to suppress the evils which the use or abuse of inebriating liquors has wrought.<sup>7</sup> There has never been any doubt as to the menace the drunk poses for our society. The Presidential Commission on Drunk Driving<sup>8</sup> states that fifty percent of all fatal accidents are caused by alcohol abuse. In Indiana, during the years 1981 to 1986, "alcohol-related vehicle accidents . . . resulted in 53,429 persons injured and 1,554 deaths."<sup>9</sup> The impact of these statistics has caused the state judiciaries and legislatures across the country to act in an effort to solve the problems occurring with the abuse of alcohol.

The advent of civil liability and dram shop acts creating liability upon the provider of alcohol is an offspring of this judicial and legislative activity. The imposition of civil liability (as opposed to criminal liability)

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\* Partner, Mitchell, Hurst, Jacobs & Dick, Indianapolis. B.A., Indiana University, 1962; J.D., with distinction, Indiana University, 1966. The author gratefully acknowledges the efforts of his research assistants, Scott Ballantine and Olivia Napariu.

1. *Black's Law Dictionary* defines "dram shop" as "[a] drinking establishment where liquors are sold to be drunk on the premises; a bar or saloon." BLACK'S LAW DICTIONARY 444 (5th ed. 1979).

2. Howie, *Three Hundred Years of the Liquor Problem in Massachusetts*, 18 MASS. L. Q. 79 (1933).

3. *Crowley v. Christensen*, 137 U.S. 86, 91 (1890).

4. 45 AM. JUR. 2D *Intoxicating Liquors* § 1 (1969).

5. British Statutes at Large, 1540-52, Ch. 25, p. 391.

6. *Sopher v. State*, 169 Ind. 177, 184, 81 N.E. 913, 915 (1907) (quoting British Statutes at Large, 1540-52, Ch. 25, p. 391).

7. *Id.* at 915-16.

8. Presidential Commission on Drunk Driving, Final Report at 1 (1983).

9. *Picadilly, Inc. v. Colvin*, 519 N.E.2d 1217, 1220 (Ind. 1988) (citing *Governor's Task Force to Reduce Drunk Driving*, 1987 Progress Report 12).



for furnishing intoxicating liquor to a willing person is a relatively recent development which began during the post civil war temperance movement.<sup>10</sup> Prior to this, it was universally held that "to either sell or give intoxicating liquor to ordinary able-bodied men"<sup>11</sup> is not a tort at common law. The reason usually given for this immunity to providers of liquor was that "the drinking of the liquor, not the furnishing of it, was the proximate cause of the injury."<sup>12</sup>

One of the earliest dram shop statutes adopted in this country was in Indiana.<sup>13</sup> This Act, passed in 1853,<sup>14</sup> led to the enactment of similar acts across the country. These statutes in their various forms were often strictly construed<sup>15</sup> and served as the basis upon which civil liability was imposed upon the provider of intoxicating liquor. Only in more recent times have the courts recognized common law liability exclusive of the theory of liability set forth in dram shop acts or liability premised upon alcoholic beverage control acts.

The leading case of *Rappaport v. Nichols*,<sup>16</sup> a 1959 New Jersey Supreme Court decision, approved the application of ordinary principles of negligence to the act of furnishing alcohol to a person who was

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10. The American Society for the Promotion of Temperance was formed in Boston in 1926 followed by the formation of the American Temperance Union in 1936. During the period from 1850 to the mid-1870's the temperance movement stagnated. Prompted by third and fourth generation protestants appalled by the post Civil War immigration of Catholics and Jews from southern and eastern Europe, the Woman's Christian Temperance Movement was founded in 1874 and quickly became a powerful political force. The Guide to American Law, Vol. 10, p. 32.

11. *Elder v. Fisher*, 247 Ind. 598, 604, 217 N.E.2d 847, 851 (1966) (quoting 30 AM. JUR. *Intoxicating Liquors* § 520 (1958)).

12. Annotation, *Common-Law Right of Action for Damage Sustained By Plaintiff in Consequence of Sale or Gift of Intoxicating Liquor or Habit-Forming Drug to Another*, 97 A.L.R.3d 528, 533 (1980). See also 45 AM. JUR. 2D *Intoxicating Liquors* § 553 (1969).

13. Goldberg, *Dram Shop Update Developments in 1986*, 22 TRIAL, Dec. 1986, at 66. The article, without citation, claims that Indiana, in 1849, was the first state to enact dram shop legislation. However, the author's research only has uncovered passage of the Act of 1853, and the earlier cited 1850 legislation. See *infra* note 14. From this research, it is unclear whether Indiana or Wisconsin first enacted legislation given the 1850 enactment in the State of Wisconsin. Goldberg, *supra*, at 67.

14. An Act to Regulate the Retailing of Spirituous Liquors, and for the Suppression of Evils Arising therefrom, ch. 66, 1853 Ind. Acts 87 (approved March 4, 1853). Interestingly, the State of Indiana as early as 1849 enacted legislation to prevent the sale of intoxicating liquors in specifically named counties. An Act more effectually to prevent the retailing of Spirituous Liquors in certain counties therein named, ch. XCII, 1849 Ind. Acts 83 (approved Jan. 16, 1849), amended by ch. CXLIX, 1850 Ind. Acts 119 (approved Jan. 19, 1850).

15. *Couchman v. Prather*, 162 Ind. 250, 252, 70 N.E. 240, 241 (1904).

16. 31 N.J. 188, 156 A.2d 1, 75 A.L.R.2d 821 (1959) *superceded by statute as noted in Renz v. Penn Cent. Corp.*, 87 N.J. 437, 435 A.2d 540 (1981).

visibly intoxicated and that such act was the proximate cause of the plaintiff's injuries. With the *Rappaport* decision came an onslaught of confusing dram shop decisions straining against the common law immunity for furnishing alcohol. Reflecting this confusion, states have held: (a) that the common law provided for liability where no state dram shop act existed;<sup>17</sup> (b) that legislatures preempted or abrogated the common law by enacting statutes;<sup>18</sup> and (c) that despite the existence of dram shop acts or alcohol beverage control acts, the common law principles of negligence applied to the provider of alcohol.<sup>19</sup> Prior to 1986, Indiana fell within the later classification.<sup>20</sup>

Since *Rappaport*, courts across the country, including Indiana, have forged new ground in expanding dram shop liability to those who furnish or serve alcoholic beverages.<sup>21</sup> In reaction to this expansion of liability and increased litigation, tavern owners and insurance lobbyists have sought and gained legislation restricting the expansion of alcohol provider liability. In 1986, nineteen states enacted laws, most of which restricted the liability of commercial and social providers.<sup>22</sup> As a part of that trend, the Indiana Legislature in 1986 enacted a civil dram shop statute<sup>23</sup> restricting liability to instances where a "person who furnishes an alcoholic beverage" has "actual knowledge" that the consumer was "visibly intoxicated."

## II. THE CO-EXISTENCE OF DRAM SHOP ACTIONS BASED ON STATUTE AND COMMON LAW PRINCIPLES IN INDIANA WHICH PRE-DATE THE 1986 DRAM SHOP STATUTE

Prior to the 1988 Indiana Supreme Court decision in *Picadilly, Inc. v. Colvin*,<sup>24</sup> the law regarding the coexistence of dram shop common law principles and liability based upon liquor statutes was confusing and

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17. *Deeds v. United States*, 306 F. Supp. 348 (D. Mont. 1969).

18. Note, *Ohio Liquor Vendors v. Highway Safety—A Legislative Compromise*, 13 OHIO N.U.L. REV. 475, 478 (1986).

19. *Waynich v. Chicago's Last Dep't Store*, 269 F.2d 322 (7th Cir. 1959), *cert. denied*, 362 U.S. 903 (1960).

20. In 1986, Indiana enacted IND. CODE § 7.1-5-10-15.5 which expressly limits liability to the terms of the statute. In 1988, *Picadilly, Inc. v. Colvin*, 519 N.E.2d 1217 (Ind. 1988), recognized liability based on common law principles of negligence even where there were also special statutory provisions on which liability could be based.

21. Beltman, *Dram Shop Liability*, 21 TRIAL, March 1985, at 38.

22. Goldberg, *supra* note 13, at 67. The nineteen states which enacted new statutes or amended existing statutes were: Arizona, California, Colorado, Connecticut, Idaho, Indiana, Iowa, Louisiana, Maine, Michigan, Montana, New Hampshire, New Mexico, Ohio, Rhode Island, Tennessee, Utah, Wisconsin and Wyoming. *Id.* at n.4.

23. IND. CODE § 7.1-5-10-15.5 (1988).

24. 519 N.E.2d 1217 (Ind. 1988).



unclear. In *Picadilly*, the court recognized that common law liability in so called dram shop cases exists notwithstanding the existence of a statute which makes such conduct criminal.<sup>25</sup> Indeed, the court held that such statute "designate[s] certain minimal duties but do[es] not thereby relieve persons from otherwise exercising reasonable care."<sup>26</sup> This judicial interpretation put to rest the historical legal confusion which existed in Indiana for over one hundred years.

In the 1858 case of *Struble v. Nodwift*,<sup>27</sup> one of the earliest dram shop cases found to mention liability arising from the common law, the Indiana Supreme Court held that the complaint which alleged both violation of the liquor law of 1853 and a common law theory of liability did not state a cause of action. The court, considering the common law question, implied that a seller of alcohol may be liable if "he sold it with a knowledge that it was purchased with intent to be applied to [an] improper use."<sup>28</sup> Apparently recognizing the implication of its discussion, the court concluded by stating that it did not "mean to intimate any opinion as to whether an action of this character, can or cannot be sustained, at all, upon common-law principles."<sup>29</sup> This decision, and many which followed, was reluctant to recognize further that common law principles of negligence applied to providers of alcohol.

The Indiana Supreme Court decided *Krach v. Heilman*<sup>30</sup> in 1876. *Krach* involved a claim by Heilman's widow against the party who sold her husband intoxicating liquor. The husband became intoxicated, was placed in the back of a wagon and on the return home was crushed by a salt barrel. The *Krach* court avoided embracing the Indiana Dram Shop Act of 1873<sup>31</sup> and held that Heilman's death was not proximately

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25. *Id.* at 1220. This proposition is supported in a recent annotation. See *Common-Law Right*, *supra* note 12, at 535-36. The specific language of the annotation states: "[i]t was held in the following cases that the plaintiff had stated a cause of action based on common-law negligence apart from any violation of liquor laws . . . ." *Id.* at 535. This reasoning, stated in reference to the sale of alcohol, applied equally to the giving of alcohol to another (social host liability). *Id.* at 566. The annotation also includes a discussion of liability for sale or gift of alcohol in violation of statutes or ordinances. *Id.* at 572.

26. 519 N.E.2d at 1220.

27. 11 Ind. 64 (1858), *superceded by statute as noted in* *Campbell v. Board of Trustees*, 495 N.E.2d 227 (Ind. Ct. App. 1986).

28. *Id.* at 66.

29. *Id.*

30. 53 Ind. 517 (1876).

31. An Act to regulate the sale of intoxicating liquors, to provide against evils resulting from any sale thereof, to furnish remedies for damages suffered by any person in consequence of such sale, prescribing penalties, to repeal all laws contravening the provisions of this act, and declaring an emergency, ch. LIX, 1873 Ind. Acts 151 (approved Feb. 27, 1873) [hereinafter *1873 Act*].

caused by the intoxicated state Krach's consumption of peach brandy had induced.<sup>32</sup> The court held that while the "remote cause" may have been his intoxication, the real cause of his death was the injury itself.<sup>33</sup> The widow was denied recovery because she was not "immediately injured by the intoxication of the deceased."<sup>34</sup> Interestingly, the court concluded: "[t]he common law does not, on the facts alleged, give the plaintiff any right of action. Her right of action, if . . . any, is based upon statute."<sup>35</sup> Arguably, this enunciation implies that a cause of action may have existed independent of statute had Heilman alleged other "facts." Of course, this interpretation, like that of *Struble*, is far from conclusive with regard to the existence of a common law right in dram shop cases.

The 1882 case of *Dunlap v. Wagner*<sup>36</sup> did not help to clarify this apparent confusion. Mr. Wagner illegally sold liquor on Sunday to a Mr. Charles Dunlap. The consumption of this liquor caused Dunlap to become intoxicated. Mr. Wagner then placed Mr. Dunlap in a sleigh and headed the horses toward Dunlap's home. The horses ran away and one received injuries which caused its death. Dunlap sued Wagner for the death of his horse. This case, like *Krach*, was based on the Indiana Dram Shop Act of 1873.<sup>37</sup> In *Dunlap*, the Indiana Supreme Court made the often quoted observation:

He [defendant] was, therefore, a wrong-doer, and wrong-doers are responsible for injuries proximately resulting from their wrongful acts. A man who, in violation of law makes another helplessly drunk, and then places him in a situation where his drunken condition is likely to bring harm to himself or injuries to others, may well be deemed *guilty of an actionable wrong independently of any statute*.<sup>38</sup>

Although *Dunlap* may be read to mean that common law principles of negligence are a basis of liability independent of statute, it is likely that the "violation of law" referred to by the court was the illegal Sunday sale of liquor as opposed to non-statutory principles of common law giving way to dram shop liability.

In 1889, citing *Dunlap*, the supreme court held in *Beem v. Chestnut*,<sup>39</sup> that Fanny Chestnut did not need to allege that she was free from

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32. 53 Ind. at 523.

33. *Id.* at 523-24.

34. *Id.* at 524.

35. *Id.* at 522.

36. 85 Ind. 529 (1882), *superceded by statute as noted in* Campbell v. Board of Trustees, 495 N.E.2d 227 (Ind. Ct. App. 1986).

37. 1873 Act, *supra* note 31.

38. 85 Ind. at 530 (emphasis added).

39. 120 Ind. 390, 22 N.E. 303 (1889).



negligence in her action against Beem, who sold liquor to her intoxicated husband who later "became crazed" and drove her from their home into the "cold" while she was "thinly clad." The court held that the violation of statute amounted to an unlawful invasion of the plaintiff's right and the doctrine of contributory negligence had no application.<sup>40</sup> However, in considering the defense of contributory negligence, the court pointed out that Mrs. Chestnut had not averred that Beem was negligent and, had she done so, "contributory negligence of the plaintiff may, as is well understood, operate as a defence."<sup>41</sup> It is unlikely that the court envisioned or considered any common law dram shop action. Nevertheless, this court, impliedly embraced the common law without expressing its principles or rejecting them. From the turn of the century until 1966, there are few reported cases based upon the sale or provision of alcohol which would have any relevance to this issue.<sup>42</sup>

The 1966 supreme court decision, *Elder v. Fisher*,<sup>43</sup> often is cited to support the proposition that "the general principles of common-law negligence should be applied to cases involving intoxicating liquor."<sup>44</sup> While confirming the existence of dram shop common law in Indiana, the *Elder* court created a challenge to its co-existence with a statute applicable to the factual circumstances, stating: "[i]n the absence of special statutory provision, the general principles of common-law negligence should be applied to cases involving intoxicating liquor."<sup>45</sup> This language has been interpreted to mean that the common-law provides for an action *only* when a plaintiff's claim does not fall under a "special statutory provision."<sup>46</sup> In view of the lack of definitive decisions preceding

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40. *Id.* at 392, 22 N.E. at 304.

41. *Id.*

42. Most of the reported decisions were based on the Civil Damage (Dram Shop) Acts, exemplified by the following cases: *Mulcahy v. Givens*, 115 Ind. 286, 17 N.E. 598 (1888); *Wall v. State ex rel. Kendall*, 10 Ind. App. 530, 38 N.E. 190 (1894); *Boos v. State ex rel. Sliney*, 11 Ind. App. 257, 39 N.E. 197 (1894); *Homire v. Halfman*, 156 Ind. 470, 60 N.E. 154 (1901); *Nelson v. State*, 32 Ind. App. 88, 69 N.E. 298 (1903); *McCarty v. State ex rel. Boone*, 162 Ind. 218, 70 N.E. 131 (1904); *Couchman v. Prather*, 162 Ind. App. 250, 70 N.E. 240 (1904); *State ex rel. Niece v. Soale*, 36 Ind. App. 73, 74 N.E. 1111 (1905); *Berkemeier v. State*, 44 Ind. App. 1, 88 N.E. 634 (1909); *Greener v. Niehaus*, 44 Ind. App. 674, 89 N.E. 377 (1909); *Banks v. State*, 188 Ind. 353, 123 N.E. 691 (1919).

43. 247 Ind. 598, 217 N.E.2d 847 (1966).

44. *Id.* at 607, 217 N.E.2d at 853.

45. *Id.*

46. *Whisman v. Fawcett*, 470 N.E.2d 73, 80 (Ind. 1984). In *Whisman*, the court held:

Elder did establish for the first time in Indiana that there is a common law action against those unlawfully selling or furnishing intoxicating liquor in favor of third persons subsequently injured by the acts of the purchasers as a result of their intoxicated condition. However, a careful review of the record shows

*Elder* bearing on the issue of Indiana common-law dram shop liability, one might question the logic of the *Elder* declaration. In fact, the legal underpinnings in *Elder* are questionable. For example, *Elder* cites the Illinois case of *Colligan v. Cousar*<sup>47</sup> which, *Elder* claims, examined several Indiana decisions and concluded that "there is a commonlaw action in Indiana against those unlawfully selling or furnishing intoxicating liquor . . . ."<sup>48</sup> This is clearly inaccurate. First, the *Colligan* court examined only a single Indiana decision (*Dunlap*) and ultimately ignored it, stating that the language cited was dictum.<sup>49</sup> *Colligan*, in fact, held: "[C]onsequently it may be said there has been no rule of common law with reference to this particular question set out in any authoritative statements of the Indiana courts."<sup>50</sup> Further, the *Elder* court incorrectly cited *Krach* in maintaining that no cases had been found which directly held "either that there is or that there is not common law dram shop liability."<sup>51</sup> The court stated that *Krach* includes dictum "to the effect that there is no common-law liability."<sup>52</sup> To support its argument that prior case law implies "that a common-law action might lie against the seller,"<sup>53</sup> the court cited the 1953 Indiana decision of *Burk v. Anderson*.<sup>54</sup> This also seems inaccurate because the *Burk* discussion centers on the new right of a wife to make a consortium claim (in Indiana only the husband's right previously existed) and the fact that no such consortium loss was incurred due to the immediate death of her spouse. Nowhere in *Burk* is there any language which would imply that a common law action might lie against the seller of alcoholic beverages. Apparently, the only authority correctly relied upon by the *Elder* court was the 1965

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the trial court ruled as it did not because it determined a common law action to be nonexistent; rather, it properly concluded that plaintiff's claim fell under specific statutory provisions which serve as a premise for a civil action for damages. Indiana law clearly endorses the proposition that a violation of the liquor laws will result in a civil action. See, e.g., *Elder*, 217 N.E.2d at 851; *Parrett v. Lebamof*, 408 N.E.2d 1344 (Ind. Ct. App. 1980); *Elsperman v. Plump*, 446 N.E.2d 1027 (Ind. Ct. App. 1983). General principles of common law negligence apply only in the absence of a special statutory provision. *Elder*, 217 N.E.2d at 853.

470 N.E.2d at 80.

47. 38 Ill. App. 2d 392, 187 N.E.2d 292 (1963).

48. *Elder*, at 607, 217 N.E.2d at 853.

49. *Colligan*, at —, 187 N.E.2d at 296. The *Colligan* court did cite other Indiana decisions, but in the context of proximate cause rather than common law dram shop liability. See *id.* at —, 187 N.E.2d at 302.

50. *Id.* at —, 187 N.E.2d at 296.

51. *Elder*, at 604, 217 N.E.2d at 851.

52. *Id.*

53. *Id.*

54. 232 Ind. 77, 109 N.E.2d 407 (1953).



supplement of *American Jurisprudence* which indicates that recent cases held there are circumstances in dram shop action where injured parties "may have a right of action at common law."<sup>55</sup>

Although dram shop litigation increased, after *Elder*, particularly in the early 1980's, little or no discussion appeared in the published cases bearing on the question of common law dram shop theories and liability. In 1984, the supreme court found in *Whisman v. Fawcett*<sup>56</sup> that *Elder* did establish "that there is a common law action against those unlawfully selling or furnishing intoxicating liquor in favor of third persons subsequently injured,"<sup>57</sup> but made no further examination of the elements of such an action. *Whisman*, interpreting *Elder*, further held that no common law cause of action existed where there were special statutory provisions.<sup>58</sup> Not until 1988, when the elements of dram shop common law were enunciated clearly, did the confusion with regard to the pre-emption of the common law by statutory enactment subside.

### III. THE 1988 DECISIONS OF *PICADILLY* AND *GARIUP*

In *Picadilly, Inc. v. Colvin*,<sup>59</sup> the Indiana Supreme Court clearly confirmed in a well-reasoned decision the existence and elements of common law negligence which may be applied to dram shop actions whether or not liquor statutes were in effect at the time of the occurrence. There are several significant holdings in the *Picadilly* decision.<sup>60</sup> This

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55. *Elder*, at 604, 217 N.E.2d at 851 (quoting 30 AM. JUR., *Intoxicating Liquors*, § 251 (Supp. 1965)). The material quoted in *Elder* is as follows:

[I]t is established that in some circumstances a vendor's sale of liquor may constitute a wilful violation of his duty to one other than the consumer thereof and be the proximate cause of the injury sustained by such third person, so that for such injury the latter may have a right of action at common law against the vendor.

56. 470 N.E.2d 73 (Ind. 1984).

57. *Id.* at 80.

58. *Id.*

59. 519 N.E.2d 1217 (Ind. 1988).

60. For a general discussion of the issues in *Picadilly*, see Harvey, *Rules, Rulings for the Trial Lawyer*, 32 RES GESTAE 14, 15-18 (1988). Additional issues addressed in *Picadilly* and not discussed in the body of this article are punitive damages, the applicable evidentiary standard for punitive damages, and post verdict motions.

In regard to punitive damages the three issues raised by the appellant, *Picadilly*, were:

1. That the award of punitive damages was improper as a matter of law and that the complaint failed to state a proper claim for relief;
2. That the trial court failed to instruct the jury in the appropriate standard for the award of punitive damages; and
3. That the presented evidence failed to show the presence of malice by a clear

Article will consider only the decision as it pertains to the common law ramifications of dram shop liability.

Picadilly is a bar licensed to sell beer, wine and liquor. It is located in a building which formerly housed a department store and covers in excess of 40,000 square feet. The method used in selling alcoholic beverages to the patrons is similar to checkout counters at a supermarket. There are eight lanes for customer use; each lane begins with a cashier where the drinks are ordered and paid for. The drink order is conveyed by computer to a bartender who prepares the drinks. The drinks then are given to a passer who places the completed order upon a counter for the customer to pick up. An intoxicated Picadilly customer driving to her home in Hope, Indiana, at 1:30 A.M., lost her way and entered an interstate highway going in the wrong direction. She collided with

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and convincing standard.

*Picadilly, Inc. v. Colvin*, 519 N.E.2d 1217, 1221 (Ind. 1988). The court quickly disposed of the first two issues and only responded to Picadilly's third allegation.

Characteristic of its entire opinion, the court succinctly rejected Picadilly's final claim of error regarding punitive damages. In writing the majority opinion, Justice Dickson quoted *Orkin Exterminating Co. v. Traina*, 486 N.E.2d 1019 (Ind. 1986), as holding that malice is not necessarily an element that need be present before the awarding of punitive damages. *Id.* at 1023. From this point, the court retried the issue to focus on the application of a clear and convincing evidentiary standard to the presented evidence. Based on prior Indiana case law, the application of a clear and convincing standard was appropriate. Specifically, the court in *Travelers Indem. Co. v. Armstrong*, 442 N.E.2d 349 (Ind. 1982), noted:

We find no fault with the end result in these cases, but it becomes apparent, from them, that the advent in punitive damages in contract cases, absent evidence of an attendant full blown tort of a nature which would permit punitive damages in and of itself, has given rise to a need for the adoption of an evidentiary standard not heretofore required, lest the public policy favoring such awards be subverted.

*Id.* at 360. The application of the greater standard of clear and convincing evidence is not limited to contract actions as suggested by the quoted language. *Bud Wolf Chevrolet, Inc. v. Robertson*, 519 N.E.2d 135, 137 (Ind. 1988).

Even though the lower court applied the appropriate standard, the Indiana Supreme Court's decision contained very little application of current law to facts. The analysis suggests a failure to stringently adhere to the application of the clear and convincing standard. Perhaps the punitive damages decision in *Picadilly* can best be understood in light of the hostility generated by drunk driving. Such a decision might have been predicted based on the court's language in *Armstrong*. The court noted:

For, just as we agree that it is better to acquit a person guilty of crime than to convict an innocent one, we cannot deny that, given that the injured party has been fully compensated, it is better to exonerate a wrongdoer from punitive damages, even though his wrong be gross or wicked, than to award them at the expense of one *whose error was one that society can tolerate* and who has already compensated the victim of his error.

*Armstrong*, 442 N.E.2d at 362 (emphasis added).



Colvin. Two separate blood tests were taken after 6:00 A.M. which showed the customer's blood alcohol content to be .114 and .1205.<sup>61</sup> Colvin filed suit against the customer and Picadilly and then settled with the customer prior to trial. The trial resulted in a verdict for Colvin. The appellate court reversed the trial court, and, following *Whisman*, held that there was no common law cause of action for dram shop liability in a situation where the plaintiff sought recovery based upon special statutory provisions.<sup>62</sup>

On appeal, the Indiana Supreme Court analogized dram shop liability to motor vehicle driving statutes, observing that, "[r]ather than preempting the common law, such statutes designate certain minimal duties but do not thereby relieve persons from otherwise exercising reasonable care."<sup>63</sup> Based upon this reasoning, the court held that *Whisman* misinterpreted *Elder* to the extent that it held "that general principles of common law negligence 'apply only in the absence of a special statutory provision.'"<sup>64</sup> The court went on to state that the correct interpretation of *Elder* is that it recognized "the common law liability *notwithstanding* the existence of such statute."<sup>65</sup>

It should be noted that the statute referred to in *Picadilly* was a criminal statute<sup>66</sup> and not a dram shop act creating a civil right of action in the person injured. The *Picadilly* court, expounding on the rationale for the application of common law principles in dram shop cases, held:

Under the common law of this State, persons engaged in the business of furnishing alcoholic beverages are not granted special exemption or privilege. They are under the same duty to exercise ordinary and reasonable care in the conduct of their operations as those involved in businesses which are not alcohol related. Such ordinary and reasonable care must be exercised for the safety of others whose injuries should reasonably have been foreseen or anticipated. The foreseeable risk of harm is indisputable.<sup>67</sup>

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61. 519 N.E.2d at 1219.

62. *Picadilly, Inc. v. Colvin*, 503 N.E.2d 421, 423 (Ind. Ct. App. 1987), *vacated*, 519 N.E.2d 1217 (Ind. 1988).

63. 519 N.E.2d at 1220.

64. *Id.* (quoting *Whisman v. Tawcett*, 470 N.E.2d 73, 80 (Ind. 1984)).

65. 519 N.E.2d at 1220 (emphasis added).

66. IND. CODE § 7.1-5-10-15(a) (1988). Section 15(a) provides: "It is unlawful for a person to sell, barter, deliver, or give away an alcoholic beverage to another person who is in a state of intoxication if the person knows that the other person is intoxicated." *Id.*

67. 519 N.E.2d at 1220.

The impact of *Picadilly* immediately became apparent with the supreme court's same day decision of *Gariup Construction Co. v. Foster*.<sup>68</sup> In *Gariup*, an employee of Gariup Construction Company became intoxicated at a 1982 Christmas party thrown by his employer. The employee left the party to pick up his wife from work, drove the wrong direction on a highway and collided with and seriously injured the plaintiff, Andrew Foster. Foster recovered the maximum from the employee's liability insurance policy and then proceeded against the employer. A jury awarded Foster a judgment of \$150,000.00, but the court of appeals reversed, basing its decision on the *Whisman* interpretation of *Elder*.

The Indiana Supreme Court, extending common law liability to the employer-provider, relied upon and quoted in detail the Restatement of Torts.<sup>69</sup> The *Gariup* discussion, therefore, is more definitive of the

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68. 519 N.E.2d 1224 (Ind. 1988).

69. The following *Restatement* sections were quoted by the Indiana Supreme Court in *Gariup*:

Sec. 302 Risk of Direct or Indirect Harm

A negligent act or omission may be one which involves an unreasonable risk of harm to another through either

- (a) the continuous operation of a force started or continued by the act or omission, or
- (b) the foreseeable action of another, a third person, an animal, or a force of nature.

*Restatement (Second) of Torts* § 302 (1965).

Sec. 302A Risk of Negligence or Recklessness of Others

An act or an omission may be negligent if the actor realizes or should realize that it involves an unreasonable risk of harm to another through the negligent or reckless conduct of the other or a third person.

*Restatement (Second) of Torts* § 302A (1965).

Sec. 308 Permitting Improper Persons to Use Things or Engage in Activities

It is negligence to permit a third person to use a thing or to engage in an activity which is under the control of the actor, if the actor knows or should know that such person intends or is likely to use the thing or to conduct himself in the activity in such a manner as to create an unreasonable risk of harm to others.

*Restatement (Second) of Torts* § 308 (1965).

Sec. 317 Duty of Master to Control Conduct of Servant

A master is under a duty to exercise reasonable care so to control his servant while acting outside the scope of his employment as to prevent him from intentionally harming others or from so conducting himself as to create an unreasonable risk of bodily harm to them,

- (a) the servant
  - (i) is upon the premises in possession of the master or upon which the servant is privileged to enter only as his servant, or
  - (ii) is using a chattel of the master, and
- (b) the master



elements of common law dram shop liability than the analysis appearing in *Picadilly*.<sup>70</sup>

Both *Picadilly* and *Gariup* arose from occurrences which pre-dated the 1986 Dram Shop Act.<sup>71</sup> This statute, which has been said to be merely a codification of existing law,<sup>72</sup> sharply restricts the liability of providers of alcohol for injuries inflicted by the people they serve.

#### IV. THE 1986 DRAM SHOP ACT

The provisions of the 1986 Dram Shop Act explicitly preempt the objective standards of the common law stated in *Picadilly* and *Gariup*. The 1986 Act provides:

- (a) As used in this Section "furnished" includes barter, deliver, sell, exchange, provide or give away.
- (b) A person who furnishes alcoholic beverage to a person *is not liable in a civil action for damages* caused by the impairment or intoxication of the person who was furnished the alcoholic beverage unless:
  - (1) the person furnishing the alcoholic beverage had *actual knowledge* that the person to whom the alcoholic beverage was furnished was *visibly intoxicated* at the time the alcoholic beverage was furnished; and

- 
- (i) knows or has reason to know that he has the ability to control his servant, and
  - (ii) knows or should know of the necessity and opportunity for exercising such control.

*Restatement (Second) of Torts* § 317 (1965).

Sec. 318 Duty of Possessor of Land or Chattels to Control Conduct of Licensee

If the actor permits a third person to use land or chattels in his possession otherwise than as a servant, he is, if present, under a duty to exercise reasonable care so to control the conduct of the third person so as to prevent him from intentionally harming others or from so conducting himself as to create an unreasonable risk of bodily harm to them, if the actor

- (a) knows or has reason to know that he has the ability to control the third person, and
- (b) knows or should know of the necessity and opportunity for exercising such control.

*Restatement (Second) of Torts* § 318 (1965).

70. Furthermore, *Gariup* noted that liability was not predicated upon a social host/guest relationship but rather on the duty of an employer who is hosting a party, which status the court felt carries with it "a significantly greater influence and control." 519 N.E.2d at 1229.

71. The incident upon which *Gariup* is based occurred on December 17, 1982. The incident discussed in *Picadilly* occurred on June 27, 1981.

72. Todd & Yosha, *Dram Shop Liability in Indiana: Analysis of Ashlock v. Norris and the New Civil Statute*, 19 IND. L. REV. 417, 419 (1986).

- (2) the intoxication of the person to whom the alcoholic beverage was furnished was a proximate cause of the death, injury, or damage alleged in the complaint.<sup>73</sup>

Clearly, the statute precludes civil liability unless it is shown that the provider had actual knowledge of intoxication. Consequently, the "see no evil" defenses relied upon by the defendants in *Picadilly* and *Gariup* probably would have prevailed had the events in these cases occurred subsequent to the Dram Shop Act.<sup>74</sup>

With certainty, dram shop defendants in cases arising after April 1, 1986, will be filing motions for summary judgment with supporting affidavits stating that they had no actual knowledge that the person served was visibly intoxicated. At first blush, it would seem impossible to successfully prosecute a claim unless the defendant admitted such guilty knowledge. This, however, may not be the case. In *Ashlock v. Norris*,<sup>75</sup> which pre-dated the 1986 Dram Shop Act, the court of appeals considered the defendant's knowledge as to the intoxication of the person served. In *Ashlock*, the defendant merely purchased drinks at a bar for an acquaintance who later, while intoxicated, struck and killed Anthony Ashlock who was jogging on the shoulder of the road.<sup>76</sup> Summary judgment was granted to the defendant.

The court of appeals reviewed the evidence, including the defendant Norris' "see no evil" deposition, answers to interrogatories and an affidavit in support of his position that the acquaintance for whom he purchased drinks did not appear to him to be intoxicated at the time.<sup>77</sup> Plaintiff Ashlock offered no rebuttal affidavit in the summary proceeding. The appellate court reversed the trial court, stating with regard to defendant's knowledge of the intoxication of the acquaintance that there was "some evidence" opposing Norris' declaration that the acquaintance did not appear intoxicated.<sup>78</sup>

It is the impression of this writer that the court in *Ashlock* did not apply principles of constructive notice or an objective standard (knew or should have known) in determining that there was sufficient evidence from which "an inference might be drawn opposing Norris' declaration that [the acquaintance] did not appear intoxicated."<sup>79</sup> Concerning Norris' state of mind or knowledge, the court noted:

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73. IND. CODE § 7.1-5-10-15.5 (1988) (emphasis added).

74. Seeger, *The Liability of Purveyors of Alcoholic Beverages in Indiana, Auto Accidents—Non-driver Liability*, 1986 INDIANA CONTINUING LEGAL EDUCATION FORUM II-18-19.

75. 475 N.E.2d 1167 (Ind. Ct. App. 1985).

76. *Id.* at 1168.

77. *Id.* at 1170.

78. *Id.*

79. *Id.* at 1170. This conclusion directly contradicts the analysis of the *Ashlock*



It would be proper *to prove by circumstantial evidence that Norris knew Morrow was intoxicated* before he last provided her a drink. As the court pointed out in *Elsperman*, there are many factors which can be considered in determining whether a person was intoxicated to another person's knowledge, including what and how much the person was known to have consumed, the time involved, the person's behavior at the time, and the person's condition shortly after leaving.<sup>80</sup>

This language may be interpreted to mean that "see no evil" defenses may be overcome with circumstantial proof of the defendant's "knowledge." In other words, the subjective defense that "I had no actual knowledge of the person's intoxication" may well be overcome by the evidence afforded by the surrounding circumstances. Such a method of proof of a state of mind is different from proving knowledge by objective standards, *i.e.*, the reasonably prudent person who knew or should have known under like or similar circumstances. Proof of subjective knowledge is not unknown in Indiana law. Indiana criminal law decisions are replete with discussions of the use of circumstantial evidence to prove actual knowledge or state of mind.<sup>81</sup>

## V. CONCLUSION

Nowhere in tort law has the deterrent effect of civil liability been more apparent than in the area of dram shop litigation. There is little doubt that these decisions have forced the providers of alcohol to control the sale and provision of alcohol. It is well known that recent Indiana decisions brought an end to happy hour cocktail time, and barroom drinking contests and created more care and concern in the barroom on the part of the waiters and bartenders about the inebriation and condition of their customers. It is hoped that the 1986 Dram Shop Act will not represent a step back in time, particularly with judicial and public recognition and concern over the growing number of alcohol-related injuries and deaths. There is little doubt that, unless the judiciary interprets the 1986 Dram Shop Act in a manner that allows victims of negligent alcohol providers to prove the provider's knowledge circum-

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decision and its knowledge requisite in *Todd & Yosha*, *supra* note 72, at 425. *Todd & Yosha* primarily rely on the language of IND. CODE § 7.1-5-10-15 as requiring subjective knowledge of intoxication by the provider of alcohol.

80. *Ashlock*, 475 N.E.2d at 1170 (emphasis added) (citation omitted).

81. Knowledge or intent may be proven from the facts and circumstances presented in each particular case. *Williams v. State*, 271 Ind. 656, 395 N.E.2d 239 (1979); *Boney v. State*, 498 N.E.2d 67 (Ind. Ct. App. 1986); *Schroer v. State*, 159 Ind. App. 522, 307 N.E.2d 587 (1974).

stantially, such conduct will go unpunished and the victims uncompensated. Without the availability of such proof, it would be the rare victim who would recover and then only in instances where the provider admits his knowledge as to the visible intoxication of the person furnished alcohol.

It is, indeed, ironic that the effect of the statute could be to insulate negligent providers from liability in light of the 1988 Indiana Supreme Court statement that "under the common law of this State, persons engaged in the business of furnishing alcoholic beverages *are not granted special exemption or privilege.*"<sup>82</sup> If, in fact, the effect of this statute is to give special exemption to providers of alcohol, the Indiana Legislature should give heed to the rationale of recent Indiana decisions allowing judgments against persons negligently furnishing alcohol and either repeal or amend the statute. Should the legislature consider amending the statute, it is suggested that the statute be amended to hold those who furnish liquor to the same standard the law usually has required, *i.e.*, the reasonable person standard.<sup>83</sup> Under such a standard, one who

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82. *Picadilly, Inc. v. Colvin*, 519 N.E.2d 1217, 1220 (Ind. 1988) (emphasis added).

83. The Ohio State Legislature in 1986 enacted Ohio Revised Code Section 4399.18. The key language of the statute allows a cause of action for damage away from a vendor's premises or parking lot if a "permit holder or his employee knowingly sold an intoxicating beverage . . ." OHIO REV. CODE ANN. § 4399.18(A) (Anderson Supp. 1987) The statute clearly requires actual knowledge of a served customer's intoxication by a liquor vendor or his employee before liability can be imposed upon a tavern owner by a third party injured by a drunk driver.

For an interesting discussion of the Ohio statute, see Comment, *Ohio Liquor Vendors v. Highway Safety—A Legislative Compromise*, 13 OHIO N.U.L. REV. 475 (1986). The author of this article argues that a subjective standard of actual knowledge results in negligence principles no longer being applicable in liquor vendor liability cases. *Id.* at 488-87. In essence, a tavern owner's liability has been narrowed for incidents that occur within his premises or in his parking lot.

In response to this narrowed liability, the author of this Ohio article prepared an amended statute. The pertinent part of the proposed statute provides:

1. A husband, wife, child, parent guardian, employer, or other person injured in person, property, or means of support by an intoxicated person . . . shall have a right of action, against any person selling intoxicating liquors which contributes in whole or in part to the intoxication of such person.

(a) The liquor vendor shall be held to a reasonable man standard . . . . Thus, where the liquor vendor knew or should have known . . . he shall be held liable, subject to the exceptions enumerated in subsection 2 of this statute, to the injured third party for damages.

. . . .

(c) Vendor liability shall attach only where the negligent operation of the patron's vehicle was a direct and proximate result of his or her intoxication.

. . . .

2. Pursuant to subsection (1)(a) of this statute, liability will not be imposed



furnishes alcohol would be liable if that person knew or should have known in the exercise of reasonable care that the person served was intoxicated.<sup>84</sup>

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. . . if the vendor can prove by a preponderance of the evidence that:

. . . .

(b) That the intoxicated individual was served only a reasonable amount of alcohol while in the liquor vendor's establishment, and that the individual exhibited no visible and/or audible signs of intoxication.

*Id.* at 492-93. This proposed statute creates a compromise between liquor vendors, and their insurance carriers, and highway and traffic safety. Under the statute, a vendor is subject to a reasonable person standard. However, the statute also provides for exceptions to this liability when due care by a vendor could not have prevented the inflicted harm.

84. The equity of this approach is virtually guaranteed by the way in which fault is allocated under Indiana's Comparative Fault Act. IND. CODE § 34-4-33-1 to -14 (1988). The primary wrongdoer, the intoxicated person, routinely will bear the greater percentage of allocated fault, thus limiting the provider's exposure. This is true, of course, only so long as joint and several liability is not found to exist within Indiana's comparative fault scheme. *See generally*, Todd & Yosha, *supra* note 72.

# A Survey of Indiana Tort Law

MICHAEL ROSIELLO\*

JOHN R. TALLEY\*\*

## I. INTRODUCTION

Although Indiana tort law broke little new ground during the survey period,<sup>1</sup> several subject areas received greater than routine scrutiny by Indiana courts. This article will devote its major emphasis to decisions clustered in six subject areas, including interpretations and applications of (1) the Indiana Comparative Fault Act,<sup>2</sup> ("Act" or "Comparative Fault Act") (2) Indiana's "impact" requirement for recovery of emotional distress damages, (3) punitive damages, (4) premises liability, (5) fraud and estoppel, and (6) liability of unincorporated associations.

## II. COMPARATIVE FAULT

The interpretations of Indiana's Comparative Fault Act made during the survey period are perhaps more significant for their broad application than the novelty of the rulings.

### A. *Abandoning the Joint Release Rule*

Typical of the analytical challenges presented by comparative fault were Judge Barker's decisions in *Fetz v. E & L Truck Rental Co.*<sup>3</sup> and *Gray v. Chacon*.<sup>4</sup> In *Fetz*, a case arising before the effective date of the Comparative Fault Act, the United States District Court for the Southern District of Indiana recognized and applied Indiana's "well-settled rule that the unqualified release of one joint tortfeasor acts to release all joint tortfeasors."<sup>5</sup> Eight months later, the court concluded

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\* Partner, Barnes & Thornburg, Indianapolis. A.B., Columbia University, 1973; J.D., Stanford University Law School, 1976.

\*\* Associate, Barnes & Thornburg, Indianapolis. B.A., Indiana University, 1982; J.D., Indiana University School of Law—Indianapolis, 1985.

1. Approximately July 31, 1987, to July 31, 1988.

2. IND. CODE §§ 34-4-33-1 to -14 (1988).

3. 670 F. Supp. 261 (S.D. Ind. 1987).

4. 684 F. Supp. 1481 (S.D. Ind. 1988).

5. 670 F. Supp. at 262. Although Judge Barker considered herself bound by the Indiana rule, she made plain her disagreement with the rule even in a contributory negligence case. 670 F. Supp. at 263 n.1 ("[t]here is little persuasive justification for this rule"). The court held that this rule did not bar the plaintiff's claim in *Fetz*, because the court found that the settling parties did not intend to release the alleged joint tortfeasors. 670 F. Supp. at 265.



in *Gray*, an action based on comparative fault, that Indiana's "anti-quoted" joint release rule "must be abandoned."<sup>6</sup> The difference in the decisions reflected more than a mere change in procedure under comparative fault. The difference reflected the new fault philosophy reflected by the Act.

Gray was injured when his truck collided with a trailer left on the roadway by Bavuso. Bavuso had rented the trailer from Jartran who allegedly failed to provide the trailer with adequate warning lights, reflectors or flares. Gil Chacon and Mienke Discount Mufflers had sold and installed Bavuso's trailer hitch. Gray settled his claim against Bavuso and executed a release of that claim. In his new lawsuit against the other alleged tortfeasors, Gray admitted the release of Bavuso but opposed the defendants' motion for summary judgment by arguing that the joint release rule was inappropriate under the Act.

The district court, undertaking to determine how the Indiana Supreme Court would decide the issue, explored the rationale for the rule set forth in *Bellew v. Byers*:<sup>7</sup>

The reasons for this rule are obvious. First, it prevents an unfair prejudice against the defendant by precluding the plaintiff from recovering in excess of his injuries by successively obtaining settlements from the various tort-feasors in return for releases. Second, joint tort-feasors "constitute, in a sense, one entity, each of them being jointly and severally liable for injury to the plaintiff." A release of one joint tort-feasor in effect releases the entire "entity." Accordingly, to release one is to release all of the others.<sup>8</sup>

Unlike joint and several liability as interpreted in negligence context,<sup>9</sup> comparative fault distributes liability among multiple tortfeasors.<sup>10</sup> Because the Act both distributes and separates liability, the court found both traditional foundations for Indiana's release rule eliminated by operation of the Act.<sup>11</sup> The Act ended the risk "that an injured party could receive more than 100% of her damages by successively recovering from multiple tortfeasors."<sup>12</sup> Further, multiple tortfeasors could no longer be considered "one entity" because each defendant would be liable only for his proportionate share of any verdict. The court concluded that

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6. *Gray*, 684 F. Supp. at 1485.

7. 272 Ind. 37, 396 N.E.2d 335 (1979).

8. *Id.* at 39, 396 N.E.2d at 336-37 (citation omitted).

9. *See Gray*, 684 F. Supp. at 1485.

10. IND. CODE § 34-4-33-5 (1988).

11. *Gray*, 684 F. Supp. at 1485.

12. *Id.* at 1484-85. *See* IND. CODE § 34-4-33-5 (1988).

“far from being ‘one entity,’ joint defendants in Indiana are now as separate and independent from each other as they are from the plaintiff herself.”<sup>13</sup>

*B. Evidence of Causation by Unnamed Nonparties Is Permissible*

In *Moore v. General Motors Corp., Delco Remy Division*,<sup>14</sup> the court declined to exclude causation evidence concerning conduct by persons not named as nonparties under the Comparative Fault Act.<sup>15</sup> Plaintiff sought, through a motion in limine, to exclude such evidence because a nonparty affirmative defense had not been pleaded. The court denied the motion, finding defendants under comparative fault can introduce such evidence without a nonparty defense where the evidence relates to contested causation issues. However, because the jury could not allocate fault to the particular nonparties in the absence of a pleaded defense, the court warned counsel to avoid misleading or confusing the jury regarding such an allocation.<sup>16</sup>

The *Moore* court reasoned that comparative fault did not have “the practical effect of abrogating all pre-existing negligence law,” and plaintiff remains obligated to establish the traditional elements of a negligence claim, including causation.<sup>17</sup> Although the Act did not explicitly address presentation of evidence concerning causation by nonparties not designated as such, the Act did expressly preserve the requirement that plaintiff prove causation.<sup>18</sup> The court concluded that defendants were entitled to contest causation by evidence of conduct by a person not pleaded as a “nonparty” under the Act.<sup>19</sup> The court’s holding, that that Act “did not materially alter the law of causation,”<sup>20</sup> required such a result.

*C. Nonparty as a “Person Who Is, or May Be, Liable to the Claimant”*

The Comparative Fault Act permits the defendant to plead the fault of a “nonparty” as an affirmative defense.<sup>21</sup> The Act contains a definition of a “nonparty”:

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13. *Gray*, 684 F. Supp. at 1485.

14. 684 F. Supp. 220 (S.D. Ind. 1988).

15. The Comparative Fault Act, as amended in 1984, permits a defendant to “assert as a defense that the damages of the claimant were caused in full or in part by a nonparty.” IND. CODE § 34-4-33-10(a) (1988). See also IND. CODE § 34-4-33-2(a) (1988) (definition of “nonparty”). However, the defendant “must affirmatively plead the defense,” IND. CODE § 34-4-33-10(b) (1988), within the time limitations set forth in the statute. See IND. CODE § 34-4-33-10(c), (d) (1988).

16. *Moore*, 684 F. Supp. at 222.

17. *Id.* at 221-22.

18. *Id.* See IND. CODE § 34-4-33-10(b) (1988).

19. *Moore*, 684 F. Supp. at 221.

20. *Id.*

21. IND. CODE § 34-4-33-10(a) (1988).



"Nonparty" means a person who is, or may be, liable to the claimant in part or in whole for the damages claimed but who has not been joined in the action as a defendant by the claimant. A nonparty shall not include the employer of the claimant.<sup>22</sup>

Three cases have addressed whether a potentially immune defendant is within this definition.

In *Huber v. Henley*,<sup>23</sup> the plaintiff alleged personal injuries from a highway accident. In this opinion, the court granted one defendant leave to amend its answer to assert the State of Indiana as a "nonparty" on the ground that the State was negligent "in the maintenance of the highway and the highway shoulder."<sup>24</sup> Plaintiff could not sue the State because plaintiff had failed to give notice within 180 days as required by the Tort Claims Act.<sup>25</sup>

The court recognized that the current version of the "nonparty" definition was intended to exclude persons who were immune from suit.<sup>26</sup> The court held, however, that the State was a proper nonparty. The court drew a distinction between a person who is immune from suit and a person against whom plaintiff has merely forfeited his claim:

A reasonable interpretation of the phrase, "a person who is, or may be, liable to the claimant" is one against whom the plaintiff would have had a right to relief. A judge acting within her official capacity would, for example, be outside this definition because against her a claimant would have no right to relief. A state official performing a discretionary function likewise cannot be held liable for errors, mistakes of judgment, or unwise decisions made in the exercise of that discretion. On the other hand, a claimant does generally have a *right* to recover against governmental entities but can forfeit that right by failing to give the prescribed notice.

Because the plaintiff had a right to recover against the Department of Highways and merely forfeited that right, the

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22. IND. CODE § 34-4-33-2(a) (1988).

23. 656 F. Supp. 508 (S.D. Ind. 1987), *clarified in* *Huber v. Henley*, 669 F. Supp. 1474 (S.D. Ind. 1987). See *infra* text accompanying notes 42-50.

24. 656 F. Supp. at 509.

25. *Id* at 510. See IND. CODE §§ 34-4-16.5-1 to -21 (1988). In *Huber*, the 180-day period had passed before the defendant filed its original answer. 656 F. Supp. at 512.

26. Under the original Comparative Fault Act, a "nonparty" was defined as "any person who is not a party to the litigation." IND. CODE § 34-4-33-5(b)(1) (Supp. 1983). "The 1984 amendment ameliorated this result somewhat by specifying that a nonparty to whom a jury may attribute fault must be a 'person who is, or may be liable to the claimant.'" 656 F. Supp. at 510.

Department of Highways can be a nonparty in this case as one "who is, or may be, liable to the claimant."<sup>27</sup>

In *Hill v. Metropolitan Trucking, Inc.*,<sup>28</sup> plaintiffs were State employees who were injured on a State highway. The defendants named other State employees as nonparties.<sup>29</sup> The court held, on two grounds, that these persons were not proper nonparties under the Comparative Fault Act.<sup>30</sup>

First, the court held that the State employees could not be liable to plaintiffs because plaintiffs' sole remedy against them is under the worker's compensation statute.<sup>31</sup> Second, and contrary to the holding in *Huber v. Henley*, the *Hill* court ruled that the State employees could not be nonparties because plaintiffs had failed to give timely notice under the Tort Claims Act:

Further, it appears that each of the would-be nonparties would fall within the coverage of Indiana's Tort Claims Act IND. CODE 34-4-16.5-1 *et seq* (sic), which requires that notice of intent to sue be given within 180 [days] of the injuries being incurred. IND. CODE 34-4-16.5-7. The would-be nonparties are immune from suit absent such notice. The record does not suggest that the Hills or Mr. Clemons' representatives gave such notice; accordingly, the record does not reflect that the would-be nonparties are or may ever be liable to the plaintiffs.

Because Mr. Hill and Mr. Clemons are not, and cannot be, liable to each other for any part of the damages the other claims, and because Mr. Forney, Mr. Shaw and Trooper Rissot are not, and cannot be, liable to either Mr. Hill or Mr. Clemons for any part of the damages either claims, the plaintiffs' motion to strike those portions of the contentions of defendants Rabayev and Metropolitan dealing with the nonparty defenses should be granted.<sup>32</sup>

The nonparty issue arose again in *Farmers & Merchants State Bank v. Norfolk & Western Railway Co.*<sup>33</sup> This was an action by three minor

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27. 656 F. Supp. at 511 (citations omitted).

28. 659 F. Supp. 430 (N.D. Ind. 1987).

29. *Id.* at 431.

30. The court also rejected plaintiffs' argument that no employee of the State could be named as a nonparty because the Act excludes "the employer of the claimant" from the definition of a nonparty. 659 F. Supp. at 434. See IND. CODE § 34-4-33-2(a) (1988).

31. *Hill*, 659 F. Supp. at 434.

32. *Id.* at 434-35.

33. 673 F. Supp. 946 (N.D. Ind. 1987).



siblings who were injured in a train crossing accident. The railroad asserted an affirmative defense naming as a nonparty plaintiffs' father, who was driving the car at the time of the accident. Plaintiffs moved to strike the defense, arguing that the father could not be a nonparty because any claim against him was barred by the parental immunity doctrine.<sup>34</sup>

The district court, noting that there was no Indiana state court authority interpreting the nonparty provision, relied upon *Huber v. Henley* and *Hill v. Metropolitan Trucking*.<sup>35</sup> After discussing both cases, the court stated: "The conclusion that Judges Barker and Miller both reached then, was that a person who is *immune* from suit cannot be a nonparty under Indiana's Comparative Fault Statute because such a person cannot be 'a person who is, or may be, liable to the claimant.'"<sup>36</sup> The court did not point out that the two earlier cases reached different results on the specific issue of naming a State entity or employee as a nonparty where no timely notice was given under the Tort Claims Act.

On the facts of the case, the court denied the motion to strike. The court acknowledged that the father could not be a nonparty if he were wholly immune from suit by plaintiffs.<sup>37</sup> Here, however, the father did not have complete immunity. "Indiana's Guest Statute . . . creates an exception to the parent-child immunity doctrine in the case of motor vehicle accidents."<sup>38</sup> Under the Guest Statute, a parent may be liable to a child for "wanton or willful misconduct."<sup>39</sup> Because there was possible parental liability, the court denied plaintiffs' motion to strike the nonparty defense.<sup>40</sup> The court stressed that the defendant would bear the burden of proving at trial that the father was guilty of "wanton or willful misconduct."<sup>41</sup>

The general principle enunciated in the three cases—that the validity of a nonparty defense turns upon whether the nonparty is immune from suit by plaintiff—appears sound. Additional decisions are necessary, however, to demarcate the precise limits of the nonparty defense. In particular the conflict between the specific holdings of *Huber v. Henley* and *Hill v. Metropolitan Trucking* will have to be resolved by the Indiana courts.

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34. *Id.* at 947.

35. *Id.* at 948.

36. *Id.* (emphasis in original) (quoting IND. CODE § 34-4-33-2 (Supp. 1984)).

37. *Id.* at 948-49.

38. *Id.* at 949. See IND. CODE § 9-3-3-1(b) (1988).

39. IND. CODE § 9-3-3-1(b)(3) (1988).

40. *Farmers*, 673 F. Supp. at 949.

41. *Id.* at n.2.

*D. Nonparties and the Statute of Repose*

In the second published *Huber v. Henley* decision,<sup>42</sup> the court clarified its prior decision,<sup>43</sup> discussed in the preceding section, which granted defendants leave to amend their answer to assert a nonparty defense. The defendants claimed fault by the State of Indiana in the design, construction, and maintenance of the roadway on which plaintiff's accident had occurred. Plaintiff's time for a notice of a tort claim against the State had expired. The first *Huber* decision held that "[b]ecause the plaintiff had a right to recover against the Department of Highways and merely forfeited that right, the Department of Highways can be a nonparty" as defined in the Act.<sup>44</sup>

Plaintiff then filed a motion for partial summary judgment on the nonparty defense because Indiana's ten-year statute of repose for improvements to real estate<sup>45</sup> shielded the State from liability, thus taking it outside the Act's definition of a "nonparty."<sup>46</sup> The court's second decision agreed in concept with plaintiff's argument that if an applicable statute of repose barred plaintiff's action the State could not be a nonparty, and distinguished its earlier holding with respect to notice under the Tort Claims Act:

[T]he statute of repose, had it applied, would have barred the plaintiff's cause of action at the instant of its accrual. The state would not have been "a person who is, or may be, liable" to the plaintiff. The plaintiff would not have forfeited his right to recovery (as he did by not giving tort claim notice within 180 days); he simply would have had no right.<sup>47</sup>

Nonetheless, the court denied the summary judgment motion on the ground that the cited real estate improvement statute of repose did not apply.<sup>48</sup> The statute of repose provides that it may not be raised as a defense "by any person in actual possession or the control of real property, either as owner, tenant or otherwise."<sup>49</sup> The court held that this limitation applied to the State, because "the state stands in the position of owner of the public roadways."<sup>50</sup>

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42. 669 F. Supp. 1474 (S.D. Ind. 1987).

43. 656 F. Supp. 508 (S.D. Ind. 1987).

44. 669 F. Supp. at 1478 (quoting 656 F. Supp. at 511). See *supra* text accompanying notes 23-27 (discussion of the holding in the first *Huber* decision).

45. IND. CODE § 34-4-20-4 (1988).

46. 669 F. Supp. at 1478.

47. *Id.* at 1479.

48. *Id.*

49. IND. CODE § 34-4-20-4 (1988).

50. 669 F. Supp. at 1479.



*E. Allocations of Fault to Dismissed Parties*

In *Bowles v. Tatom*,<sup>51</sup> the court reversed an allocation of fault that did not reflect evidence of fault by a defendant who had been dismissed from the action at the close of plaintiff's case. Tatom was injured in a car accident after Bowles failed to obey a stop sign covered by dense foliage. Tatom sued Bowles, the City of Bedford, its mayor, and the adjacent property owners.

At trial, plaintiff presented no evidence to establish liability by the city, the mayor, or the adjacent landowners. After plaintiff rested his case, the court dismissed claims against each of those parties pursuant to Indiana Trial Rule 50(A).<sup>52</sup> In her case, however, Bowles testified and introduced evidence of fault by some or all the dismissed parties. Specifically, Bowles produced evidence that the disregarded stop sign had been obscured by foliage. After hearing all evidence, the trial court entered a judgment in favor of Tatom, finding Bowles one hundred percent at fault and assessing damages accordingly.

Bowles' undisputed evidence of the obscured stop sign led the court of appeals to find clearly erroneous the trial court's assessment of one hundred percent fault against Bowles. Although the appellate court held in *Walters v. Dean*<sup>53</sup> that fault may not be allocated to a nonparty where the defense is not properly pleaded, the landowners and city were parties in *Bowles*. Thus, under the plain terms of the statute, a nonparty defense could not have been pleaded against those co-defendants.<sup>54</sup> *Bowles* characterized *Walters* as based on a policy of providing to a plaintiff fair notice of possible empty-chair defenses so those nonparties could be added as defendants if still feasible.<sup>55</sup> *Bowles* distinguished that reasoning from the Act's allocation of fault between named parties in a lawsuit.<sup>56</sup> Because "[a] defendant does not have to point at another pleaded party to invoke the fault allocation process of the Comparative Fault Act," the court found the dismissal of the adjacent landowners and City resulted "merely in a bar to Tatom's obtaining a judgment against those defendants" rather than a finding on the merits that they were not, and could not be, at fault.<sup>57</sup>

In dissent, Judge Conover argued that the city, the mayor, and the adjacent landowners did not meet the statutory nonparty definition.<sup>58</sup>

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51. 523 N.E.2d 458 (Ind. Ct. App. 1988).

52. Ind. R. T. P. 50(A) (1988) (Judgment on the Evidence).

53. 497 N.E.2d 247 (Ind. Ct. App. 1986).

54. IND. CODE § 34-4-33-2(a) (1988).

55. *Bowles*, 523 N.E.2d at 461.

56. *Id.*

57. *Id.*

58. *Id.* at 462 (Conover, J., dissenting).

The Act defines a "nonparty" as "a person who is, or may be, liable to the claimant."<sup>59</sup> Judge Conover stated that the trial court's Trial Rule 50(A) judgment "amounted to a determination of zero percent fault as to each such defendant as a matter of law."<sup>60</sup> Accordingly, Judge Conover reasoned that those parties could not be nonparties because they could not be liable to the claimant.<sup>61</sup>

The authors of this Article believe that *Bowles* was correctly decided. As the court noted, dismissal at the close of plaintiff's case is only a ruling that plaintiff cannot recover from the dismissed defendant. The apportionment of fault is an analytically different issue, which remains whether or not the defendant is dismissed. In addition, Judge Conover's position could lead to unfair results. The co-defendant cannot control plaintiff's presentation of evidence. There is no reason to penalize the co-defendant—who may have ample evidence that the dismissed defendant was at fault—because plaintiff failed (or chose not) to present that evidence.<sup>62</sup> The result, under the dissent's analysis, would be to exempt the dismissed defendant from the allocation of fault. Apart from the possible unfairness to co-defendants, this does not seem to square with the Legislature's intent in passing the Comparative Fault Act—to apportion fault among all persons involved in an accident.<sup>63</sup>

#### *F. Inconsistent Allocations of Fault on Related Claims*

The effect of inconsistent allocations of fault was at issue in *Paul v. Kuntz*.<sup>64</sup> Mark Paul and Bill Kuntz, both minors, were injured when the automobile in which they were riding struck a tree. Paul sued Kuntz,

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59. IND. CODE § 34-4-33-2(a) (1988).

60. 523 N.E.2d at 462 (Conover, J., dissenting).

61. *Id.*

62. One can imagine how a plaintiff could take unfair advantage of the dissent's position. Assume there are four possible parties at fault. Three are judgment-proof; the fourth is a deep pocket. The plaintiff sues all four but purposely presents no evidence at trial as to the impecunious trio, all of whom are dismissed at the close of plaintiff's case. The solvent defendant would be deprived of the opportunity of reducing his liability by establishing the fault of the co-defendants.

63. Moreover, Trial Rule 50(A) can be applied reasonably and fairly in a comparative fault action. The ultimate reduction in plaintiff's recovery made possible where a dismissal is granted need not foreclose the granting of such a motion at the close of a plaintiff's case. Plaintiff's burden is merely to produce sufficient evidence from which a particular co-defendant could be found liable for at least some fault allocation. Such a threshold is not high, but a judgment on the evidence should be granted for failure to meet the threshold. Thorough discovery should reveal whether one defendant claims that another defendant is at fault and what evidence, if any, exists of that fault. Accordingly, plaintiff's failure to present adequate proof of a defendant's fault can fairly result in a Trial Rule 50(A) dismissal.

64. 524 N.E.2d 1326 (Ind. Ct. App. 1988).



claiming Kuntz had been driving the automobile. Kuntz counterclaimed, claiming that Paul had been driving. Trial was to the court, which made special findings of fact on the complaint and counterclaim. The trial court determined Kuntz was the driver, but on Paul's complaint determined that Paul was 54 percent at fault and Kuntz 38 percent at fault. A non-party was assigned 8 percent fault. On the Kuntz counterclaim, the court determined that Kuntz was 54 percent at fault and Paul was 46 percent at fault. Accordingly, the court entered judgment against Paul on his complaint and against Kuntz on his counterclaim, so that neither party was awarded any recovery.

On appeal, Paul argued the inconsistent fault allocations were erroneous. Kuntz defended the allocations, arguing the findings of fault on the counterclaim were not binding as findings of fault on the complaint.

Finding the judgment to contain irreconcilable differences arising from a common set of facts, the court of appeals reversed, reasoning that "a factfinder on a single set of facts and circumstances cannot reach two different conclusions of fact as expressed in its findings or verdicts that will support valid judgments if the opposite, inconsistent conclusions are irreconcilable."<sup>65</sup> Because the trial court's special findings and conclusions failed to disclose any factual basis for the facial discrepancy in the allocations of fault, the appellate court held that new findings of fact and a consistent allocation of fault were required.<sup>66</sup>

The same principle would seem to apply in a jury trial. The Comparative Fault Act has a specific provision on inconsistent verdicts, but it addresses "verdicts in which the ultimate amounts awarded are inconsistent with [the jury's] determinations of total damages and percentages of fault."<sup>67</sup> The statute directs the trial court to inform the jury of the inconsistencies and to direct the jury to resume deliberations to cure them.<sup>68</sup> This would appear to be the correct approach in the trial court if the jury returns verdicts that are "inconsistent" in the different sense at issue in *Paul v. Kuntz*. If, however, the trial court discharges the jury without correcting inconsistent allocations of fault on different claims arising from the same incident, then it appears that a new trial would be necessary.

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65. *Id.* at 1329 (citing *Fanning v. McCarry*, 2 Ill. App. 3d 650, 275 N.E.2d 897 (1971)).

66. 524 N.E.2d at 1329.

67. IND. CODE § 34-4-33-9 (1988). *See also* IND. CODE § 34-4-33-5 (1988) (describing how the jury allocates fault and determines damages); IND. CODE § 34-4-33-6 (1988) (forms of verdicts).

68. IND. CODE § 34-4-33-8 (1988).

### III. RECOVERY OF DAMAGES FOR EMOTIONAL DISTRESS

Despite continued adherence to the formal rule that emotional distress damages may be awarded only where the plaintiff suffers a contemporaneous physical injury, Indiana courts slowly but steadily have expanded the number of cases in which plaintiff can recover emotional distress damages. In 1976, Indiana created an exception to the rule for cases involving intentional infliction of emotional distress where circumstances indicated emotional trauma was foreseeably and "inextricably intertwined" with the deliberate wrong.<sup>69</sup> This exception has been applied to an increasingly broad range of conduct, including fraud actions where no physical sign of mental distress was shown.<sup>70</sup>

In 1978, the Indiana Court of Appeals questioned the soundness of the contemporaneous physical injury rule while holding that a needle prick satisfied the requirement of contemporaneous physical injury.<sup>71</sup> The rule quickly became known as an "impact rule" rather than solely as a "physical injury rule."<sup>72</sup> At least one subsequent interpretation left open the question of whether only "impact," rather than injury, is required.<sup>73</sup> In 1981, Justice Hunter noted in a dissent to denial of transfer that only five other American jurisdictions regard the impact rule "as a viable proposition of law."<sup>74</sup> Since 1981, at least two of those jurisdictions have abandoned the rule.<sup>75</sup>

During the survey period, the "impact rule" was interpreted in a decision holding that one suffering an impact could recover for the emotional distress caused by witnessing injury to another<sup>76</sup> and in a decision allowing recovery in a "garden variety" fraud case where plaintiffs presented no evidence of physical symptoms of mental anguish.<sup>77</sup> A third decision took a more conservative view of the impact rule.<sup>78</sup>

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69. *Charlie Stuart Oldsmobile v. Smith*, 171 Ind. App. 315, 327, 357 N.E.2d 247, 254 (1976), *vacated in part on other grounds on reh'g*, 175 Ind. App. 1, 369 N.E.2d 947 (1977). See *infra* text accompanying note 99.

70. *Groves v. First Nat'l Bank of Valparaiso*, 518 N.E.2d 819 (Ind. Ct. App. 1988).

71. *Kroger Co. v. Beck*, 176 Ind. App. 202, 208 n.5, 375 N.E.2d 640, 645 n.5 (1978) (the needle was in a steak; plaintiff's injury was a throat puncture wound).

72. *Little v. Williamson*, 441 N.E.2d 974, 975 (Ind. Ct. App. 1982).

73. *Id.* at n.3 (avoiding issue of whether the rule "requires actual harm or if mere physical contact is sufficient").

74. *Elza v. Liberty Loan Corp.*, 426 N.E.2d 1302, 1308 (Ind. 1981) (Hunter, J., dissenting to denial of transfer).

75. See *Pieters v. B-Right Trucking, Inc.*, 669 F. Supp. 1463, 1471-72 (N.D. Ind. 1987).

76. *Id.*

77. *Groves v. First Nat'l Bank of Valparaiso*, 518 N.E.2d 819 (Ind. Ct. App. 1988).

78. *Wishard Memorial Hosp. v. Logwood*, 512 N.E.2d 1126 (Ind. Ct. App. 1987).



Discussion of these decisions follows, but reconciliation will require further court interpretation.

*A. Recovery for Witnessing Injury to Another*

The impact rule was interpreted to allow damages for the mental distress suffered in witnessing injury to another in *Pieters v. B-Right Trucking, Inc.*<sup>79</sup> Karey Pieters and her fiancée were in a car that crashed, in the dark, into a truck parked on the road. The truck had been abandoned in the traveled portion of the road apparently without flares, reflectors, or other types of warning devices behind or beside the trailer. Karey Pieters suffered a broken thumb and injured hip. Her fiancée died several hours after the crash.

Shortly before trial, defendant filed two motions in limine seeking to exclude emotional distress evidence. After an extensive analysis of the history and policy foundations for the impact rule, the court held that plaintiff could recover damages for the emotional distress she suffered from witnessing her fiancée's death and thus denied the motions in limine.

*Pieters* discussed the three different rules utilized by state courts in deciding whether emotional distress damages should be awarded: (1) the zone of danger rule, (2) the foreseeability rule, and (3) the impact rule.<sup>80</sup> The zone of danger rule allows emotional distress damages to be recovered only by plaintiffs who were within the range of ordinary physical peril. The foreseeability analysis is the least restrictive and allows recovery if defendant should have foreseen the possibility of fright or shock severe enough to cause substantial injury in a normal person. The impact rule requires contemporaneous physical injury before emotional distress damages may be recovered.<sup>81</sup>

Indiana adopted the impact rule in 1897,<sup>82</sup> and it "has steadfastly been adhered to since."<sup>83</sup> There was no dispute that plaintiff had suffered contemporaneous physical injuries.<sup>84</sup> The issue was whether she could recover damages for the emotional distress caused by the fact that she witnessed the injuries to her fiancée. The court held that:

A thorough review of Indiana's other impact cases convinces the court that the impact rule, as applied by Indiana courts,

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79. 669 F. Supp. 1463, 1466 (N.D. Ind. 1987).

80. *Id.*

81. *Id.*

82. *Id.* (citing *Kalen v. Terre Haute & I.R.R.*, 18 Ind. App. 202, 47 N.E.2d 694 (1897)).

83. 669 F. Supp. at 1466 (citing, *Captain & Co., Inc. v. Stenberg*, 505 N.E.2d 88, 100 (Ind. App. 1987)).

84. 669 F. Supp. at 1467.

has not been used to preclude recovery for emotional distress due to another's injuries when the plaintiff has suffered an impact and contemporaneous physical injury and when the other injuries and the plaintiff's injuries result from the same impact.<sup>85</sup>

In addition to discussing the prior cases,<sup>86</sup> the court noted that its holding was consistent with the three policies underlying the impact rule:

First, courts feared that absent impact, claims for emotional distress would flood the courts with litigation. Second, courts feared that the absence of an impact requirement would spawn fraudulent claims. Third, courts feared that it would be too difficult to prove the causal connection between the damages claimed and the defendant's negligence.<sup>87</sup>

Here, "[t]he plaintiff already has a claim for emotional distress for her own injuries,"<sup>88</sup> "[t]here is no suggestion that her claim is fraudulent,"<sup>89</sup> and "[p]roving damages will be no more difficult if she recovers for the distress caused by her fiancé's injuries and death."<sup>90</sup> The court concluded that, "the recovery [under the court's holding] will certainly be more accurate and complete, which is precisely the kind of recovery the law ought to give."<sup>91</sup>

The court then surveyed cases from other jurisdictions, noting that most jurisdictions would allow plaintiff to recover emotional distress damages based upon the injuries suffered by her fiancée.<sup>92</sup> "The trend in this area of the law clearly favors recovery."<sup>93</sup>

Until Indiana state courts address the *Pieters* holding, the decision will remain controversial. The defendants in *Pieters* argued that *Boston v. Chesapeake & Ohio Railway*,<sup>94</sup> an Indiana Supreme Court decision,

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85. 669 F. Supp. at 1469 (citations omitted); see also *id.* at 1473 (holding restated).

86. *Id.* at 1467-70.

87. *Id.* at 1470.

88. *Id.* at 1470-71.

89. *Id.* at 1471.

90. *Id.*

91. *Id.* The court also noted that "scholars agree that the fears which form the foundation of the [impact] rule have little basis in reality." *Id.* (citations omitted).

The court simply points out the fact that the reasons for the rule, even if taken as true, do not prevent recovery in this case. The reasons for the rule essentially relate to the question of when damages for emotional distress are recoverable, *i.e.*, upon impact. Once a plaintiff meets this test the reasons for the rule fall away and cannot be resurrected to raise an artificial wall. It makes no sense to use the rule in that way.

*Id.*

92. 669 F. Supp. at 1471-73.

93. *Id.* at 1473.

94. 223 Ind. 425, 61 N.E.2d 326 (1945).



limited mental anguish damages to those directly resulting from the physical injury suffered. The *Pieters* court correctly noted that *Chesapeake* does not expressly exclude damages arising from witnessing injury to another.<sup>95</sup> Such a result, however, can be fairly inferred from the *Chesapeake* ruling.<sup>96</sup> Indeed, only one month before the *Pieters* decision, the Indiana Court of Appeals in *Wishard Memorial Hospital v. Logwood*,<sup>97</sup> stated the impact rule as follows: "In Indiana, the general rule is that a person can recover damages for mental anguish only when it is accompanied by, *and results from*, a physical injury."<sup>98</sup>

The distinction between allowing damages which "result from" an impact, as described in *Logwood* and *Chesapeake*, and allowing an action for all mental distress caused after impact is the issue upon which *Pieters* will remain controversial. Only further clarification of Indiana's impact rule will settle the issue of whether recoverable damages for mental distress are those directly arising from the injuries suffered.

### *B. Recovery of Emotional Distress Damages in Intentional Tort Actions*

Indiana's exception to the rule for some intentional torts originated in *Charlie Stuart Oldsmobile, Inc. v. Smith*,<sup>99</sup> where the court recognized an exception to the general rule of the requirement of an impact:

Indiana courts have awarded compensatory damages for mental anguish unaccompanied by physical injury in certain tort actions involving the invasion of a legal right which by its very nature

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95. 669 F. Supp. at 1469.

96. The *Chesapeake* court stated that "the complete rule would add that before recovery can be had for mental injury, including every form of distress, brooding, or fright, *it must appear to be the natural and direct result of the physical injury*, and not merely a remote consequence thereof." 223 Ind. at 428-29, 61 N.E.2d at 327 (emphasis added).

97. 512 N.E.2d 1126 (Ind. Ct. App. 1987).

98. *Id.* at 1127 (emphasis added) (citing *Boston v. Chesapeake & O. Ry.*, 223 Ind. 425, 428-29, 61 N.E.2d 326, 327 (1945)). *Pieters*, ironically, appears to recognize a right to recovery that would not be allowed in California, the jurisdiction long considered the most liberal in allowing emotional distress damages. In *Elden v. Sheldon*, 46 Cal. 3d 267, 758 P.2d 582, 250 Cal. Rptr. 254 (1988), the California Supreme Court held a plaintiff could not recover damages for witnessing the death of a live-in girlfriend because there was no legally-recognized family relationship between the parties. The *Elden* court specifically disapproved the holding in *Ledger v. Tippitt*, 164 Cal. App. 3d 625, 210 Cal. Rptr. 814 (1985), allowing emotional distress damages based upon injury to a fiancée. 46 Cal. 3d at \_\_\_\_, 758 P.2d at 588, 250 Cal. Rptr. at 260. In *Pieters*, the court did not expressly consider a requirement of family relationship.

99. 171 Ind. App. 315, 357 N.E.2d 247 (1976), *vacated in part on other grounds on reh'g*, 175 Ind. App. 1, 369 N.E.2d 947 (1977).

is likely to provoke an emotional disturbance. False imprisonment and assault actions are examples of instances in which a disagreeable emotional experience would normally be expected to be inextricably intertwined with the nature of the deliberate wrong committed, thereby lending credence to a claim for mental disturbance. The conduct of defendant in such circumstances is characterized as being willful, callous, or malicious, which may produce a variety of reactions, such as fright, shock, humiliation, insult, vexation, inconvenience, worry, or apprehension.<sup>100</sup>

In *Baker v. American States Insurance Co.*,<sup>101</sup> the court added fraud to the type of actions in which damages could be recovered for mental anguish absent a showing of contemporaneous physical injury.<sup>102</sup>

During the survey period, the Indiana Court of Appeals allowed recovery of damages for mental anguish in a fraud case without a contemporaneous physical injury, and without subsequent physical symptoms, although the court ultimately reversed the \$100,000 award for mental anguish as excessive.

The plaintiffs in *Groves v. First National Bank of Valparaiso*<sup>103</sup> had purchased real estate from the First National Bank of Valparaiso. The Bank had represented that it had clear title to the realty. The Groves invested substantial time and money making improvements to the realty and were "frightened and angry" when they learned they had not received good title.<sup>104</sup> However, the Groves did not introduce "any evidence that they experienced any physical manifestations, sleeplessness, depression, or other observable indicia of emotional distress."<sup>105</sup> Despite the lack of physical symptoms, the court concluded emotional distress damages properly could be awarded, although "in the absence of evidence of any physical or psychological manifestation of mental anguish, the award

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100. *Id.* at 327, 357 N.E.2d at 254.

101. 428 N.E.2d 1342 (Ind. Ct. App. 1981).

102. The *Baker* court reversed the dismissal of an action claiming fraud in connection with a workers compensation claim. On the claim for emotional distress, the court stated: The tort of fraud, if proven, would clearly constitute an invasion of a legal right. Furthermore, the question of whether this kind of intentional invasion of a legal right is likely to cause an emotional disturbance is for the trier of fact. We cannot say as a matter of law that Baker could not, under the allegations of his amended complaint, show that his claim falls within the exception to the impact rule.

428 N.E.2d at 1349-50. Fraud had been mentioned in *Charlie Stuart* as one of the examples of intentional torts for which other jurisdictions allowed recovery. 171 Ind. App. at 327, 357 N.E.2d at 254.

103. 518 N.E.2d 819 (Ind. Ct. App. 1988).

104. *Id.* at 831.

105. *Id.*



of nearly \$100,000 is so high as to demonstrate passion or prejudice on the part of the jury."<sup>106</sup>

As the *Groves* decision points out, damages for emotional distress have "no precise standards of measurement."<sup>107</sup> Further, "[p]hysical and mental pain are, by their very nature, not readily susceptible to quantification, and, therefore, the jury is given very wide latitude in determining these kinds of damages."<sup>108</sup> Despite the range of jury discretion permitted, *Groves* demonstrates that an appellate court can retain control of excessive awards. After consideration of similar damage awards and the extent of the emotional distress evidence presented, the court reversed the jury's award for mental anguish.<sup>109</sup>

*Groves* is notable for allowing recovery in an ordinary fraud case in the absence of physical indicia of mental distress. Emotional distress damages awarded on this basis are, in effect, a type of punitive damages. The authors believe that emotional distress damages should be reserved for cases where there is probative evidence of a true emotional trauma. Requiring proof of some physical effect is a reasonable requirement, particularly where the alleged mental distress arises from a commercial transaction. Misapplication of the *Charlie Stuart* exception opens emotional distress to virtually any action in which some type of intentional or willful misconduct is alleged.

#### IV. PUNITIVE DAMAGES

In *Bud Wolf Chevrolet, Inc. v. Robertson*,<sup>110</sup> the supreme court held that proof of malice is not an essential element in recovering punitive damages in Indiana, under either tort or contract theories.<sup>111</sup> The court further approved a punitive damages instruction given to the jury and affirmed a substantial punitive damages award.<sup>112</sup>

The Robertsons had purchased a truck from Bud Wolf Chevrolet after being told it was "new" and had only been used by a salesman to drive back and forth to work. The Robertsons were not told that the truck had been involved in an accident prior to sale which had bent the frame cross rail and resulted in numerous other repairs. After a jury trial in the Marion Circuit Court, judgment was entered for the Robertsons in the amount of \$3,500 in compensatory damages and

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106. *Id.* at 832.

107. *Id.* at 831.

108. *Id.*

109. *Id.* at 832. The court ordered a new trial on the issue of damages.

110. 519 N.E.2d 135 (Ind. 1988).

111. *Id.* at 137.

112. *Id.* at 138.

\$75,000 in punitive damages.<sup>113</sup> The court of appeals initially affirmed the compensatory damage award and reversed the punitive damage award.<sup>114</sup> The appeals court held: "The evidence, though permitting a conclusion of tortious conduct sufficient to support compensatory damages, does not permit a conclusion of malice sufficient to support an award of punitive damages."<sup>115</sup> On rehearing,<sup>116</sup> the court of appeals reinstated the punitive damage award, on the ground that Bud Wolf Chevrolet had not objected to the punitive damages instruction and the award was appropriate under that instruction.<sup>117</sup> The appeals court acknowledged that this change in result created a conflict with the decision of another district.<sup>118</sup>

The supreme court granted defendant's petition to transfer,<sup>119</sup> vacated the court of appeals' ruling on punitive damages,<sup>120</sup> and affirmed the trial court on this issue.<sup>121</sup> The court noted that existing Indiana law relating to recovery of punitive damages in a contract action requires (1) proof of "a serious wrong, tortious in nature,"<sup>122</sup> (2) proof that "the public interest will be served by the deterrent effect of the punitive damages,"<sup>123</sup> and (3) "further evidence 'inconsistent with the hypothesis that the tortious conduct was the result of a mistake of law or fact, honest error of judgment, overzealousness, mere negligence or other noniniquitous human failing.'"<sup>124</sup> The supreme court rejected the court of appeals' holding on malice, stating that: "[I]n both tort and contract actions, while proof of malice may be relevant to show the obduracy necessary for punitive damages, the element of malice is a mere alter-

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113. *Id.* at 135.

114. *Bud Wolf Chevrolet, Inc. v. Robertson*, 496 N.E.2d 771, 777 (Ind. Ct. App. 1986), *modified on reh'g*, 508 N.E.2d 567 (Ind. Ct. App. 1987).

115. 496 N.E.2d at 777.

116. *Bud Wolf Chevrolet, Inc. v. Robertson*, 508 N.E.2d 567 (Ind. Ct. App. 1987), *vacated*, 519 N.E.2d 135 (Ind. 1988).

117. 508 N.E.2d at 570-71.

118. *Id.* at 571 (noting the conflict with *Martin Chevrolet Sales, Inc. v. Dover*, 501 N.E.2d 1122 (Ind. Ct. App. 1986)).

119. See IND. R. APP. P. 11(B)(2)(c) ("[e]rrors upon which a petition to transfer shall be based may include . . . that there is a conflict between the opinion or memorandum decision and a prior opinion of the Court of Appeals").

120. 519 N.E.2d at 138.

121. *Id.*

122. *Id.* at 136 (quoting *Vernon Fire & Casualty Ins. Co. v. Sharp*, 264 Ind. 599, 608, 349 N.E.2d 173, 180 (1976)).

123. 519 N.E.2d at 136-37 (quoting *Art Hill Ford, Inc. v. Callender*, 423 N.E.2d 601, 602 (Ind. 1981)).

124. 519 N.E.2d at 137 (quoting *Travelers Indem. Co. v. Armstrong*, 442 N.E.2d 349, 362 (Ind. 1982)).



native, not an essential prerequisite, to obtain punitive damages.”<sup>125</sup> The court went on to decide:

In the present case, the jury could have found by clear and convincing evidence both (1) that Bud Wolf’s conduct, even if not proven to be malicious, nevertheless constituted fraud, gross negligence or oppressiveness, and (2) that Bud Wolf’s conduct was inconsistent with any contention of mistake of law or fact, honest error of judgment, overzealousness, mere negligence, or other such noniniquitous human failing.<sup>126</sup>

The court also addressed the “public interest” issue, and it appears clear from its discussion that the court considered this an important issue in light of the facts of the case: “We agree with Robertson that public policy cannot condone a dealer taking a vehicle that has been extensively damaged, repair it so as to conceal the damage, and then sell it as new at full price with impunity.”<sup>127</sup>

Also noteworthy in the *Bud Wolf Chevrolet* decision is the Indiana Supreme Court’s approval of a jury instruction which includes a definition of “clear and convincing evidence,” the standard of proof necessary to recover punitive damages. Under the approved instruction: “[c]lear and convincing evidence may be defined as an intermediate standard of proof greater than a preponderance of the evidence and less than proof beyond a reasonable doubt and requires the existence of a fact be highly probable.”<sup>128</sup>

Although the supreme court affirmed a punitive damage award in *Bud Wolf Chevrolet*, the authors do not believe that the decision itself made any fundamental change in Indiana punitive damages law. The facts in *Bud Wolf Chevrolet* appear to have been egregious. The supreme court’s ruling on those facts, therefore, is consistent with the recent trend of supreme court cases holding, in substance, that punitive damage awards are to be limited to the relatively few cases where extreme wrongful conduct is clearly proved.<sup>129</sup>

## V. PREMISES LIABILITY

Perhaps the most remarkable feature of premises liability law in Indiana is the amount of attention and time required from Indiana

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125. 519 N.E.2d at 137.

126. *Id.*

127. *Id.*

128. *Id.* at 138 (quoting trial court’s jury instructions).

129. See, e.g., *Orkin Exterminating Co. v. Traina*, 486 N.E.2d 1019, 1022-23 (Ind. 1986); *Travelers Indem. Co. v. Armstrong*, 442 N.E.2d 349, 358-61 (Ind. 1982).

courts to interpret it.<sup>130</sup> During the survey, probably as much appellate court energy was devoted to interpreting Indiana's law of premises liability as to any other substantive area of tort law. One reason the topic might take so much judicial time could be Indiana's cumbersome three-part duty analysis, which requires classification of persons as invitees, licensees or trespassers. The harshness of Indiana's rule that a landowner owes a licensee only the duty to keep from willfully or wantonly hurting him has spurred considerable judicial effort in creating "implied invitees,"<sup>131</sup> "business visitors,"<sup>132</sup> "public invitees,"<sup>133</sup> "business invitees,"<sup>134</sup> and fact issues over whether a person is an invitee.<sup>135</sup>

*A. Prior Law: "Intention" Versus "Foreseeability" in Determining Premises Liability*

The confusing and convoluted nature of Indiana law on the topic is illustrated by *J. C. Penney Co. v. Wesolek*.<sup>136</sup> Ruth Wesolek fell on an escalator that malfunctioned in a J. C. Penney Store. The trial court instructed the jury on the duty owed to a licensee. After the jury returned a verdict for J. C. Penney, the trial court granted a new trial, ruling that it should have instructed the jury that Wesolek was an invitee. The difference in classification was vital—if Wesolek was a licensee, J. C. Penney needed only to refrain from willfully or wantonly injuring her; if an invitee, J. C. Penney had to exercise due care to keep its property in a reasonably safe condition for her. On appeal, rather than adopting a position that all customers or potential customers are invitees, the *Wesolek* court found that the question of whether plaintiff was an invitee or a licensee depended in part on her purpose for being in the store.<sup>137</sup>

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130. At least seven appellate decisions were published on this subject in the survey period. In addition to the cases discussed below, see generally *Morris v. Scottsdale Mall Partners, Ltd.*, 523 N.E.2d 457 (Ind. Ct. App. 1988); *Sowers v. Tri-County Tel. Co.*, 512 N.E.2d 208 (Ind. Ct. App. 1987); *Howard v. H. J. Ricks Constr. Co.*, 509 N.E.2d 201 (Ind. Ct. App. 1987).

131. See, e.g., *Hoosier Cardinal Corp. v. Brizuis*, 136 Ind. App. 363, 371, 199 N.E.2d 481, 485 (1964).

132. See, e.g., *Fleischer v. Hebrew Orthodox Congregation*, 504 N.E.2d 320, 322 (Ind. Ct. App. 1987) (citing *Mullins v. Easton*, 176 Ind. App. 590, 376 N.E.2d 1178 (1978); RESTATEMENT (SECOND) OF TORTS § 332 (1965)).

133. See, e.g., *City of Bloomington v. Kuruzovich*, 517 N.E.2d 408, 412-13 (Ind. Ct. App. 1987).

134. See, e.g., *Sowers v. Tri-County Tel. Co. Inc.*, 512 N.E.2d 208, 210 (Ind. Ct. App. 1987).

135. See, e.g., *J.C. Penney Co. v. Wesolek*, 461 N.E.2d 1149, 1152-53 (Ind. Ct. App. 1984).

136. 461 N.E.2d 1149 (Ind. Ct. App. 1984).

137. *Id.* at 1153. Plaintiff's status also depended in part upon J.C. Penney's purpose for holding its store open to the public and whether plaintiff's purpose for entering the premises corresponded with that purpose. *Id.*



Consequently, "[w]hether Ruth made a purchase in Penney's before her fall is crucial to the determination of her status at the time of her fall. . . . [i]f not, her status was that of a licensee."<sup>138</sup>

The *Wesolek* decision avoided the more difficult issue: whether stores should owe a reasonable duty of care to all persons in traveled areas during business hours. The *Wesolek* decision reduced the determination to an examination of whether the customer was browsing, shopping, or just passing through. Yet, whether Ruth Wesolek make a purchase or was just passing through the store to a common mall area, the danger she encountered was the same. More importantly, there is no question that J. C. Penney encouraged, and benefited from the presence of, persons entering or passing through the store for any reason. In addition, because there are "invitees" in J. C. Penney's stores throughout the business day, the finding that some shoppers are mere "licensees" would do nothing to reduce the cost to J. C. Penney of meeting its duty to protect invitees. For all of these reasons, the shopper's intention does not appear to be a rational basis for determination of the store's liability concerning the danger.

Not all Indiana cases rely on artificial distinctions as the court did in *Wesolek*. In *Ember v. BFD, Inc.*,<sup>139</sup> the court of appeals ruled that premises liability could be extended for a condition off the premises of the landowner.<sup>140</sup> A bar patron sued after being injured and assaulted in a parking lot across from the bar. The bar's co-manager admitted receiving complaints prior to the assault concerning excessive noise, crowd problems, and criminal activity on the streets adjacent to the bar. The bar's management also had been aware of at least five or six violent incidents inside or outside the tavern. The bar employed two uniformed police officers, including one posted outside the bar. To quell neighborhood complaints, the bar distributed a flyer to the local neighborhood advising individuals to call the bar regarding problems or to call city police if their complaint concerned a serious incident. The bar did not own or lease the parking lot on which the assault occurred.<sup>141</sup>

The trial court granted summary judgment for the bar. The court of appeals reversed, basing its decision on two alternative grounds: (a) the bar gratuitously might have assumed the duty to patrol adjacent areas; and (b) the responsibility of a landowner could extend beyond the land owned.<sup>142</sup>

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138. *Id.*

139. 490 N.E.2d 764 (Ind. Ct. App. 1986).

140. *Id.* at 772.

141. *Id.* at 766-68.

142. *Id.* at 773.

As to the latter ground, the court held that "[a] duty of reasonable care may be extended beyond the business premises when it is reasonable for invitees to believe the invitor controls premises adjacent to his own or where the invitor knows his invitees customarily use such adjacent premises in connection with the invitation."<sup>143</sup> The court further found that

"[w]hen the activities conducted on the business premises affect the risk of injury off the premises, the landowner may be under a duty to correct the condition or guard against foreseeable injuries. . . . *The polestar of liability, as in other negligence actions, is the foreseeable risk of harm created by the invitor's activities.*"<sup>144</sup>

Perhaps the most interesting aspect of *Ember* is its reliance on the "polestar" of foreseeability. Foreseeability plays only a limited role in Indiana's traditional analysis of a landowner's duty. Proof of foreseeability is of absolutely no assistance to a trespasser and of only limited solace to a licensee.<sup>145</sup> Yet, *Ember* concludes that foreseeability plays a central role in premises liability analysis where plaintiff is held to be an invitee.

### B. Adoption of the "Public Invitee" Test

In *City of Bloomington v. Kuruzovich*,<sup>146</sup> the Fourth District of the Indiana Court of Appeals adopted the "public invitee" test as set forth in the Restatement (Second) of Torts. Under the Restatement provision: "A public invitee is a person who is invited to enter or remain on land as a member of the public for a purpose for which the land is held open to the public."<sup>147</sup> The "public invitee" test, adopted by the Third District of the Indiana Court of Appeals in *Fleischer v. Hebrew Orthodox Congregation*,<sup>148</sup> expands the definition of potential invitees by recognizing

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143. *Id.* at 772.

144. *Id.* (emphasis added).

145. Trespassers and licensees take the premises as found. See *Gaboury v. Ireland Rd. Grace Brethren*, 446 N.E.2d 1310, 1314 (Ind. 1983); *Barbre v. Indianapolis Water Co.*, 400 N.E.2d 1142, 1146 (Ind. Ct. App. 1980). In addition, some Indiana cases suggest a landowner has only the duty not to injure a trespasser after discovering his presence. *Chicago, S.S. & S.B.R. v. Sagala*, 140 Ind. App. 650, 654, 221 N.E.2d 371, 374 (1966); *Standard Oil Co. of Indiana, Inc. v. Scoville*, 132 Ind. App. 521, 524, 175 N.E.2d 711, 713 (1961).

146. 517 N.E.2d 408 (Ind. Ct. App. 1987).

147. RESTATEMENT (SECOND) OF TORTS § 333(2) (1965).

148. 504 N.E.2d 320 (Ind. Ct. App. 1987). In *Fleischer*, the plaintiff had been injured while attending a service in a synagogue. *Id.* at 321. The court of appeals reversed summary judgment for the defendant synagogue on the ground that the plaintiff was a "public invitee." *Id.* at 324.



a landowner can be liable under the invitee standard to one whose presence on the property is not necessarily for the economic benefit of the landowner.

In *Kuruzovich*, plaintiff was injured while warming up for a softball game on property maintained as a park by the City of Bloomington. While backing up to catch a fly ball, Kuruzovich tripped over a raised manhole cover located near the ball field. After concluding that the City of Bloomington retained control over the park, the court addressed Kuruzovich's status on the property. The court noted that the facts presented the issue of whether one could ever be an invitee absent an economic benefit to the defendant.<sup>149</sup> The court declared that *Fleischer's* adoption of the public invitee rule was a "salutary development in the law of this state,"<sup>150</sup> and held that "when one invites the public or a large segment thereof, on to property for a particular purpose, he is liable to those he invites on to the land for any hazardous conditions he causes or negligently allows to remain on the land."<sup>151</sup>

Adoption of the public invitee doctrine was crucial to the outcome of the *Kuruzovich* case. If *Kuruzovich* had been found to be a licensee, the City of Bloomington should have prevailed because a licensee takes the premises as found. The City of Bloomington would have had no affirmative duty to keep the property safe for Kuruzovich, and the unconcealed nature of the raised manhole would have been his responsibility to detect and heed.

In another court of appeals decision, the first district addressed, but did not expressly adopt the "public invitee" test.<sup>152</sup> The Supreme Court of Indiana will ultimately have to decide whether the "public invitee" doctrine is recognized by Indiana law. Although neither court of appeals' decision addressed the issue specifically, there seems to be little doubt that adoption of the "public invitee" doctrine would reject the rationale and overrule the result of cases like *J. C. Penney Co. v. Wesolek*.<sup>153</sup> As noted in a comment to the Restatement:

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149. 517 N.E.2d at 413.

150. *Id.*

151. *Id.*

152. *French v. Sunburst Properties, Inc.*, 521 N.E.2d 1355 (Ind. Ct. App. 1988). See the discussion of *French* in Part V(E), *infra* notes 166-72 and accompanying text. In *French*, the court rejected the plaintiff's claim that he was a public invitee because he had entered the defendant's apartment complex (chasing his dog) "for his own convenience," *id.* at 1356, and not "for a purpose for which the land is held open to the public," as required by section 332(2) of the Restatement. RESTATEMENT (SECOND) OF TORTS § 332(2) (1965). In light of this holding, it was not necessary for the court to decide whether it would adopt the "public invitee" doctrine, but nothing in the opinion indicated any inclination to reject it.

153. 461 N.E.2d 1149 (Ind. Ct. App. 1984).

[T]he fact that a building is used as a shop gives the public reason to believe that the shopkeeper desires them to enter or is willing to permit their entrance, not only for the purpose of buying but also for the purpose of looking at goods displayed therein or even for the purpose of passing through the shop. This is true because shopkeepers as a class regard the presence of the public for any of these purposes as tending to increase their business.<sup>154</sup>

Future decisions from the Indiana courts will determine the standards applicable to determining "invitee" status, and will thereby establish the extent of landowners' duties.

### C. "Ongoing Business Relation" Makes Plaintiff an Invitee

In *Stainko v. Tri-State Coach Lines, Inc.*,<sup>155</sup> a salesman for a company selling bus maintenance items sued after injury in a bus terminal. Stainko had an ongoing relationship with Tri-State and had visited its garage several times to solicit business and make deliveries. Typically, Stainko entered the garage through a side door or an overhead door and walked to the parts department to meet Tri-State's purchasing agent. After the meeting, Stainko would leave by the same route.<sup>156</sup>

On January 27, 1982, Stainko made a sales call to the Tri-State garage. The purchasing agent was not in his usual place at the parts department, but his secretary told Stainko to go out in the garage to find him. The garage was dark. The only light provided was far to the back of the garage where a mechanic was working. Stainko had done business with that mechanic before and began to walk towards him. On his way, Stainko fell into an uncovered, unlighted and unguarded pit.<sup>157</sup> The trial court granted summary judgment for Tri-State. The court of appeals reversed.

Tri-State argued that Stainko was a mere licensee as a matter of law. Because a licensee under Indiana law "takes the premises as he finds them,"<sup>158</sup> Tri-State argued Stainko was barred from recovery. The court rejected that proposition, on the ground that "Stainko and Tri-State had an ongoing business relationship to the economic benefit of both parties."<sup>159</sup> The "ongoing business relationship" was sufficient to

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154. RESTATEMENT (SECOND) OF TORTS § 332 comment c (1965).

155. 508 N.E.2d 1362 (Ind. Ct. App. 1987).

156. *Id.* at 1363.

157. *Id.*

158. *Id.* at 1364. See also *Barbre v. Indianapolis Water Co.*, 400 N.E.2d 1142, 1146 (Ind. Ct. App. 1980).

159. *Stainko*, 508 N.E.2d at 1364.



allow Stainko to be considered an invitee regardless of the fact that he was not on the property to buy a ticket or to ride a bus, the primary business of Tri-State.<sup>160</sup>

*D. "Fireman's Rule" Extended to Police Officers*

In *Sports Bench, Inc. v. McPherson*,<sup>161</sup> the court extended the "fireman's rule" to policemen. The "fireman's rule" provides that "professionals, whose occupations by nature expose them to particular risks, may not hold another negligent for creating the situation to which they respond in their professional capacity."<sup>162</sup> Plaintiffs, who were deputy sheriffs, were shot by a patron of the defendant bar while they were off duty. Plaintiffs had arrived at the bar and were told that the assailant had been there earlier and had threatened to return with a gun. When the assailant returned, plaintiffs attempted to arrest him. The court of appeals reversed the trial court's denial of defendant's motion for summary judgment. The court characterized the fireman's rule as classifying firemen, policemen and other officers who responded in their official capacities as licensees for purposes of landowner liability.<sup>163</sup> "Accordingly, firemen, policemen, and other officers incur the inherent risks of the situation when they act in their professional capacities."<sup>164</sup> Because in Indiana the determination of whether or not an officer is performing official, professional duties "does not depend on whether he is on or off duty,"<sup>165</sup> the court used the fireman's rule to apply licensee status to plaintiffs even though they had been off duty at the time of the incident.

*E. Licensee Bears Risk of Dangers on Property*

In *French v. Sunburst Properties, Inc.*,<sup>166</sup> the court considered the scope of public invitation for property left open to the public. French was injured when he tripped over a cable strung between a series of posts on the edge of an apartment complex. French was not a resident of the apartment complex but had entered the complex during early-morning darkness to search for his lost dog. The trial court determined that French was a mere licensee and granted summary judgment for the defendant apartment complex.

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160. *Id.*

161. 509 N.E.2d 233 (Ind. Ct. App. 1987).

162. *Id.* at 235 (quoting *Keohn v. Devereaux*, 495 N.E.2d 211, 215 (Ind. Ct. App. 1986)).

163. 509 N.E.2d at 235.

164. *Id.*

165. *Id.*

166. 521 N.E.2d 1355 (Ind. Ct. App. 1988).

On appeal, the court affirmed. First the court rejected the plaintiff's claim that he was a "public invitee" under the Restatement (Second) of Torts.<sup>167</sup> Without expressly adopting the "public invitee" doctrine, the court held that the plaintiff failed to meet the criteria of a "public invitee":

[T]he test "require[s] that the visitor enter the premises for the particular purpose for which the occupant has encouraged the public to do so." If the visitor meets the requirement of a public invitee, then the occupant owes him a duty of reasonable care to keep the premises safe for him.<sup>168</sup>

The court concluded that "the trial court properly determined, as a matter of law, that [plaintiff] enjoyed only licensee status."<sup>169</sup>

The court noted the definition of the duty owed a licensee:

The only affirmative duty a landowner owes to a licensee is to refrain from willfully or wantonly injuring him or acting in a way which would increase the licensee's peril. A showing by the licensee of mere negligence on the part of the landowner will not be enough to insure him recovery.<sup>170</sup>

The court stated that because there was no evidence that the apartment complex "impliedly invited or encouraged pet owners from surrounding areas to enter its premises in order to engage in the nocturnal pursuit of their wayfaring pets,"<sup>171</sup> French was a mere licensee. Considering the licensee status, the court stated: "[U]nless Sunburst acted to create a concealed danger, unavoidable even by the exercise of reasonable skill and care, it cannot be held liable for French's injuries."<sup>172</sup>

Landowner liability cases decided during the survey period continued to apply Indiana's traditional distinctions based on the plaintiff's status upon the property at the time of the accident. Although *Ember* appeared to signal a change in landowner liability law toward giving greater consideration to the foreseeability of injury, subsequent decisions have not expanded that analysis.

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167. *Id.* at 1356-57 (discussing RESTATEMENT (SECOND) OF TORTS § 332 (1965)). See the discussion of the "public invitee" issue in Part V(B), *supra* notes 146-54 and accompanying text.

168. 521 N.E.2d at 1356 (quoting *Fleischer v. Hebrew Orthodox Congregation*, 504 N.E.2d 320, 323 (Ind. Ct. App. 1987)).

169. 521 N.E.2d at 1356-57.

170. *Id.* at 1356 (quoting *Barbre v. Indianapolis Water Co.*, 400 N.E.2d 1142, 1146 (Ind. Ct. App. 1980)).

171. 521 N.E.2d at 1356.

172. *Id.* at 1357.



## VI. FRAUD AND ESTOPPEL

The Indiana Court of Appeals addressed the elements of constructive fraud from two different perspectives during the survey period. In *Sanders v. Townsend*,<sup>173</sup> the court considered the elements of constructive fraud in the context of an attorney-client relationship. In *Reeve v. Georgia-Pacific Corp.*,<sup>174</sup> the court addressed the elements of a claim for equitable estoppel based on a misrepresentation of law, which it stated were essentially the same as the elements for constructive fraud.

A. *Constructive Fraud*

The Sanders were disgruntled personal injury plaintiffs who sued their former attorneys, alleging that "they were coerced into an inadequate and unfair settlement."<sup>175</sup> The trial court granted summary judgment for defendants.

On appeal, the court upheld the dismissal of the negligence claims because plaintiffs failed to present evidence that any settlement or verdict award without the alleged negligence would have been greater than the settlement actually received.<sup>176</sup> The court reversed, however, the lower court's summary judgment on the constructive fraud claim.

In considering the elements of constructive fraud, the court discussed the standard of care for those in a fiduciary relationship as much higher than parties who negotiate at arm's length. The court stated:

In cases of constructive fraud, intent to deceive is not required because the parties involved are not at arm's length. The element of intent is replaced by the element of the special relationship between the parties as, for example, the fiduciary relationship. Thus, although the tort of actual fraud vindicates the moral principle, one should refrain from representations intended to work a fraud, the tort of constructive fraud vindicates the principle that, in the special relationship encompassed within the purview of the tort, the dominant party must take care not to injure, even inadvertently, the rights of the weaker party, who has relied on the dominant party for expertise, skill, abilities and guidance in an area in which the weaker party is unversed.<sup>177</sup>

Having thus distinguished constructive fraud and legal malpractice, the court further distinguished the type of damage suffered: "[I]n a

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173. 509 N.E.2d 860 (Ind. Ct. App. 1987).

174. 510 N.E.2d 1378 (Ind. Ct. App. 1987).

175. *Sanders*, 509 N.E.2d at 862.

176. *Id.* at 863-65.

177. *Id.* at 866.

legal negligence claim, the injury is the loss of the worth of the underlying claim; but, with respect to constructive fraud where fiduciary duties are breached, the primary injury is the loss of rights belonging to the weaker party.”<sup>178</sup>

Although the court found the injury suffered to be “the deprivation of the right to choose between trial or settlement, or rejection of one settlement offer in hopes of a better offer,”<sup>179</sup> the court gave little guidance in deciding how to value such damage. The court noted that loss of value of the underlying claim is not the exclusive measure of damages and that nominal damages may be awarded.<sup>180</sup> The court also noted, however, that “more than nominal damages may be appropriate. For example, forfeiture of attorneys fees may be appropriate.”<sup>181</sup> In *dicta*, the court described a Minnesota case finding an attorney who breaches a fiduciary duty to a client forfeits his right to compensation without any requirement that the client prove special damages and without regard to whether the fraud was intentional or only constructive.<sup>182</sup>

### B. Equitable Estoppel

In *Reeve v. Georgia-Pacific Corp.*,<sup>183</sup> the court noted that the elements which comprised the equitable estoppel defense are “essentially those which would give rise to a claim for actual or constructive fraud.”<sup>184</sup> The court stated that negligence can be the basis of estoppel.<sup>185</sup> Furthermore, although the general rule is that estoppel arises on misrepresentation of past or existing facts and not upon promises to be performed in the future, expressions of opinion, or misrepresentations as to the state of the law, the court held that “[o]ne of the exceptions to the general rule is where a party expressing the opinion claims or expresses a special knowledge,”<sup>186</sup> and “[e]xpression of an opinion as to the law is part of the rule concerning expressions of opinion.”<sup>187</sup>

Georgia-Pacific had entered into an agreement to pay Reeve and her minor son based on the work-related death of Reeve’s husband. The payments were to continue over time until the son achieved majority or finished school. In the spring of 1983, Reeve inquired of Georgia-

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178. *Id.*

179. *Id.* at 867.

180. *Id.*

181. *Id.*

182. *Id.* (discussing *Rice v. Perl*, 320 N.W.2d 407 (Minn. 1982)).

183. 510 N.E.2d 1378 (Ind. Ct. App. 1987).

184. *Id.* at 1382.

185. *Id.* at 1383.

186. *Id.*

187. *Id.*



Pacific what affect, if any, remarriage would have on her and her son's benefits. Georgia-Pacific wrote a letter telling Reeve her son would continue to receive benefits. Four months later, Reeve remarried, and Georgia-Pacific subsequently tried to revoke payments.<sup>188</sup>

The Industrial Board found the benefits could be revoked; the court of appeals reversed. Because Georgia-Pacific had superior knowledge as to the rights to benefits, the appellate court held that Reeve could assert equitable estoppel based on Georgia-Pacific's admitted misrepresentation of law.<sup>189</sup> The appellate court also rejected arguments by Georgia-Pacific that estoppel was not applicable because the misrepresentation was not one of existing fact or condition but was a future promise. Noting that "[t]he doctrine of promissory estoppel exists in Indiana. . . [a]s an exception to the general rule,"<sup>190</sup> the court held that Reeve's remarriage in reliance on Georgia-Pacific's representations was sufficient to give rise to estoppel.<sup>191</sup>

## VII. PRE-EXISTING MENTAL WEAKNESS

In *Brokers, Inc. v. White*,<sup>192</sup> the Indiana Court of Appeals held that a tortfeasor is responsible for complications resulting from a pre-existing mental weakness as well as pre-existing physical weaknesses.

White fell in a supermarket and was taken to a hospital complaining of neck and lower back pain and numbness in the lower extremities. Her doctor observed a bruise on her lower back but found no spinal injury which would prevent her from walking. Nevertheless, White left the hospital in a wheelchair and claimed to be unable to walk. White was examined eventually by a psychiatrist, who concluded that she was suffering from a "conversion reaction." The psychiatrist testified at trial that a person manifesting a "conversion reaction" or "conversion hysteria" turns her mental anxiety into a physical disturbance such as paralysis of the arms or legs.<sup>193</sup> Other expert witnesses testified that White was predisposed to a conversion reaction.<sup>194</sup>

After a jury verdict for the grocery store, White moved to correct errors based on the refusal of the trial court to give an instruction that a negligent party is not relieved from liability merely because of a pre-existing condition of the injured party which made her more susceptible

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188. *Id.* at 1379-80.

189. *Id.* at 1384.

190. *Id.*

191. *Id.*

192. 513 N.E.2d 200 (Ind. Ct. App. 1987).

193. *Id.* at 202.

194. *Id.*

to injury. The trial court granted the motion to correct errors and the grocery store appealed.<sup>195</sup>

On appeal, the grocery store argued that the pre-existing condition rule applied only to pre-existing physical weaknesses rather than mental weaknesses.<sup>196</sup> The court affirmed the granting of a new trial, concluding that the pre-existing condition rule applies to mental weaknesses as well as physical weaknesses. The court analyzed the issue as a question of proximate cause: "[I]f the negligent conduct causes any physical injury, and if there is any evidence that a mental condition resulted therefrom, the issue whether the mental illness is a natural and direct result of such physical injury is a question of fact."<sup>197</sup> The court noted that: "The jury question of proximate cause remains even where the jury is instructed that the defendant is not relieved from liability merely because a pre-existing condition of the plaintiff makes him more susceptible to injury."<sup>198</sup>

*Brokers* does not appear to extend the law concerning pre-existing weaknesses, but clarifies that such arguments apply to both mental and physical conditions.

#### VIII. LIABILITY OF AN UNINCORPORATED ASSOCIATION TO ITS MEMBERS

During the survey period, the Indiana Supreme Court in *Calvary Baptist Church v. Joseph*<sup>199</sup> reaffirmed the common law rule that a member of an unincorporated association cannot sue the association for tortious conduct of another member. Although the court recognized certain limited exceptions to this rule, the court overruled an Indiana Court of Appeals precedent to the contrary that had stood for ten years.<sup>200</sup>

James Joseph was a member and deacon of the Calvary Baptist Church. Joseph volunteered to help other members of the church fix

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195. *Id.*

196. *Id.* at 204. The grocery store relied on the following language: "It is clear that a tortfeasor takes the person he injures as he finds him. The tortfeasor is not relieved from liability merely because a pre-existing *physical* condition of the injured party makes him more susceptible to injury." *Id.* (quoting *Johnson v. Bender*, 174 Ind. App. 638, 644, 369 N.E.2d 936, 940 (1977) (emphasis added)).

197. 513 N.E.2d at 204. The court cited and relied upon emotional distress cases, noting that there was no dispute that plaintiff had suffered a contemporaneous physical injury. *Id.* See also Part III of this Article, *supra* notes 69-109 and accompanying text.

198. 513 N.E.2d at 205.

199. 522 N.E.2d 371 (Ind. 1988).

200. *Id.* at 373, *overruling* *O'Bryant v. Veterans of Foreign Wars*, 176 Ind. App. 509, 376 N.E.2d 521 (1978).



the roof of the church building. While on the roof, another member moved the ladder to the roof and apparently left it on an unsolid footing. When Joseph stepped on the ladder to descend, he fell and was injured. The trial court granted summary judgment to the defendant church, and the court of appeals reversed. The supreme court vacated the court of appeals and affirmed the trial court.<sup>201</sup>

The court of appeals, although noting that the common law rule followed by a majority of jurisdictions would bar the plaintiff's suit by a member against an unincorporated association, followed *O'Bryant v. Veterans of Foreign Wars*,<sup>202</sup> which held that Indiana had rejected the common law rule.<sup>203</sup> *O'Bryant* had considered the effect of Indiana Trial Rule 17(B) and 17(E), which both provide that an "unincorporated association may sue or be sued in its common name."<sup>204</sup> Because the rules were adopted by both the legislature and the Indiana Supreme Court, *O'Bryant* reasoned that the rules changed prior contrary substantive Indiana law on the issue.<sup>205</sup>

In *Calvary Baptist Church v. Joseph*,<sup>206</sup> the Indiana Supreme Court expressly overruled *O'Bryant* and followed the common law principle that a member of an unincorporated association cannot recover in a tort action from the association. The court explained the rationale of the rule:

The theory of the general rule is that the members of an unincorporated association are engaged in a joint enterprise. The negligence of each member in the prosecution of that enterprise is imputable to each and every other member so that the member who has suffered damages through the tortious conduct of another member of the association may not recover from the association for such damages. It would be akin to the person suing himself as each member becomes both a principal and an agent as to all other members for the actions of the group itself.<sup>207</sup>

In rejecting the basis of the *O'Bryant* holding, the court stated: "We do not see that it was the intention of the legislature nor this court in authorizing [Trial Rules 17(B) and 17(E)] to change the substantive rule

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201. *Id.* at 372.

202. 176 Ind. App. 509, 376 N.E.2d 521 (1978).

203. *Joseph v. Calvary Baptist Church*, 500 N.E.2d 250, 252 (Ind. Ct. App. 1986).

204. Ind. R. T. P. 17(B) (Capacity to Sue or Be Sued) and 17(E) (Partnerships and Unincorporated Associations).

205. 176 Ind. App. at 513, 376 N.E.2d at 523.

206. 522 N.E.2d 371 (Ind. 1988).

207. *Id.* at 374-75.

of non-liability of association to members for torts committed by other members.”<sup>208</sup>

Although the supreme court held that the common law rule is still in effect in Indiana, the court noted that exceptions to the rule are possible: “[W]e recognize the wisdom of applying an exception to the general rule in the case of large unincorporated associations such as labor unions having a hierarchy of structure that drastically changes the relationship of membership to association and the control that a member has in its affairs.”<sup>209</sup>

The *Calvary Baptist Church* decision relied heavily on a theory that members of an unincorporated association are engaged in a “joint enterprise.”<sup>210</sup> To the extent that factual issues arise in a case as to whether or not the unincorporated association falls within the rules, a practitioner would be well advised to look to arguments concerning whether the “joint enterprise” policy basis of the rule has been met.

## IX. CONCLUSION

During the survey period, interpretations of the Comparative Fault Act continued to be the most-watched developments in Indiana’s tort law. The decisions during the survey period help in interpreting the Act, but numerous questions remain and substantial uncertainty exists with respect to nonparty practice and other issues.

In other areas of tort law, there were no decisions announcing fundamentally new tort doctrines. In the areas of recovery for emotional distress and premises liability, Indiana courts continued to explore the limits of older doctrines and suggested that those doctrines may have to be recast. Indeed, that process already may be underway. On the other hand, the supreme court rejected an attempt by the court of appeals to adopt a new rule on liability of unincorporated associations, reaffirming the traditional legal rule. The year’s decisions in tort cases thus demonstrated the ebb and flow of the common law, the constant process of accretion by which legal doctrines are formed and changed.

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208. *Id.* at 373.

209. 522 N.E.2d at 375.

210. *Id.* at 374.





# Medical Malpractice

THOMAS R. RUGE\*

## I. INTRODUCTION

In five medical malpractice cases decided during the survey period, Indiana courts set new precedent. The areas of law addressed in these decisions are: (A) limitation of actions against diagnostic (as opposed to treating) health care providers; (B) the ability/inability of corporations to practice medicine and therefore be responsible for negligent acts; (C) how to proceed where there are multiple defendants, some of whom are "qualified" under the Indiana Medical Malpractice Act<sup>1</sup> (the "Act") and others are not so qualified; (D) plaintiff's burden of proof on damages where there is a preexisting medical condition and other possible causes of injury; and (E) the authority of trial courts: (1) to order a medical review panel to render a specific expert opinion; (2) to determine the standard of care in lack of informed consent cases; and (3) to define the term, "a factor," as used in Indiana Code section 16-9.5-9-7(e). The 1988 legislative session brought one relatively minor addition to the Act.

This survey will first review the cases setting new precedent. A discussion of the one legislative change and criticism of the overall lack of action in the legislature will follow.

## II. COURT DECISIONS

### A. *Limitation of Actions Against Diagnostic Health Care Providers*

Indiana's statute of limitations in medical malpractice actions is an "occurrence" rather than a "discovery" statute.<sup>2</sup> A lawsuit for medical malpractice must be filed within two years from the date the alleged negligent act occurred rather than from the date it was discovered. However, there are exceptions where the negligent act is a "continuing wrong" and where the health care provider has failed to disclose material information to the patient. The continuing wrong theory is applicable

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\* Partner, Ruge & Ruppert, Indianapolis. B.A., Indiana University-Bloomington, 1971; J.D., Valparaiso University School of Law, 1976. The author gratefully acknowledges the assistance of Robert Davis in the preparation of this Article.

1. IND. CODE §§ 16-9.5-1-1 to -10-3 (1988).

2. IND. CODE § 16-9.5-3-1(a)(1988); *Corlbert v. Waitt*, 445 N.E.2d 1000, 1002 (Ind. Ct. App. 1982).



where the entire course of conduct combines to produce an injury. The statute of limitations is tolled so that it does not commence running until the continuing wrongful act ceases.<sup>3</sup>

The doctrine of fraudulent concealment operates to estop a defendant from asserting a statute of limitations defense when he has, either by deception or violation of a duty, concealed from the plaintiff material facts thereby preventing the plaintiff from discovering the malpractice . . . . The failure of the physician's duty to disclose that which he knows, or in the exercise of reasonable care should have known, satisfies the conduct requirement and constitutes a constructive fraud. This constructive fraud terminates with the termination of the physician/patient relationship and the statute of limitations begins to run. Also, when a patient learns of the malpractice, or discovers information which would lead to discovery of a malpractice, if the patient exercises reasonable diligence, the statute will commence to run.<sup>4</sup>

In *Walters v. Rinker*,<sup>5</sup> decided March 29, 1988, the court addressed how the principles of "continuing wrong" and "constructive fraud" should be applied for determining limitations to the right of action against a diagnostician engaged by a patient's treating physician. In *Walters*, Rinker was examined by his family doctor, G. R. Hershberger, who referred him to a specialist, Dr. Mortola. Dr. Mortola examined Rinker on July 14, 1983, and found a lump in Rinker's right thigh area. The lump was surgically removed and then analyzed by a pathologist, defendant William Walters, D.O. On August 16, 1983, Dr. Hershberger received Walters' report which ruled out malignancy. Rinker's health declined and he was admitted to another facility and was diagnosed as having large cell lymphoma on April 5, 1985. The proposed complaint against Dr. Walters was filed with the Indiana Insurance Commissioner on July 10, 1986. Dr. Walters invoked the jurisdiction of the trial court for the purpose of raising the affirmative defense of the statute of limitations.<sup>6</sup> The defendant's motion to dismiss was based on two arguments: the running of the statute of limitations and no physician/patient relationship between defendant and plaintiff. The trial court denied the motion to dismiss but granted Dr. Walters' motion for

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3. Frady v. Hedgcock, 497 N.E.2d 620, 622 (Ind. Ct. App. 1986).

4. Spoljaric v. Pangan, 466 N.E.2d 37, 40 (Ind. Ct. App. 1984), *quoted in* Ferrell v. Geisler, 505 N.E.2d 137, 139 (Ind. Ct. App. 1987).

5. 520 N.E.2d 468 (Ind. Ct. App. 1988).

6. IND. CODE § 16-9.5-10-2 (1988).

certification of the interlocutory appeal, which was then entertained by the Court of Appeals.

The appeals court first dealt with Dr. Walters' argument that no physician/patient relationship existed. This argument was found to be without merit due to the broad language setting out the scope of the Act.<sup>7</sup> The court also found no merit to another of Dr. Walters' contentions, *i.e.*, that the relationship between himself and Rinker was a non-consensual one because Rinker did not personally seek Dr. Walters' assistance. The court found that a consensual physician/patient relationship existed between Walters and Rinker because Rinker's family physician requested the diagnostic work on Mr. Rinker's behalf.<sup>8</sup>

Finally, the court determined the duration of the physician/patient relationship between Walters and Rinker. The duration issue was crucial in applying either the "continuing course of treatment" or "fraudulent concealment" theories to determine when the statute of limitations began to run. Rinker argued that the doctor was a part of a therapeutic team of physicians whose relationship with Rinker did not terminate until he was no longer under the care of his family physician, Dr. Hersherberger. The court found no Indiana cases on this question and turned to New York law for its analysis. In the past, New York courts had held that a diagnostician constructively participated in the treatment of a patient so long as the treatment continued.<sup>9</sup> Constructive participation by a pathologist in the patient's treatment was accepted by New York courts until reversed in a series of decisions from 1982 through 1986.<sup>10</sup> The New York courts reasoned:

Generally, a laboratory neither has a continuing or other relevant relationship with the patient nor, as an independent contractor, does it act as an agent for the doctor or otherwise act in relevant association with the physician. A laboratory does not have the opportunity to discover an error in a report. Instead, it must rely upon the treating physician to discover any diagnostic mistake. Therefore, the policy underlying the continuous treatment doctrine generally will not apply to the independent laboratory.<sup>11</sup>

The *Walters* court found the current New York view persuasive and held that Dr. Walters' relationship with Mr. Rinker terminated on August

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7. *Walters*, 520 N.E.2d at 471. See IND. CODE § 16-9.5-1-1(h), (i) (1988).

8. 520 N.E.2d at 472.

9. *Fonda v. Paulson*, 46 A.D.2d 540, 363 N.Y.S.2d 841 (1975).

10. *Meath v. Mishrick*, 68 N.Y.2d 992, 503 N.E.2d 115, 510 N.Y.S.2d 560 (1986); *McDermott v. Torre*, 56 N.Y.2d 339, 437 N.E.2d 1108, 452 N.Y.S.2d 351 (1982).

11. *Walters*, 520 N.E.2d at 473 (quoting *McDermott*, 56 N.Y.2d at 408, 437 N.E.2d at 112, 452 N.Y.S.2d at 355).



10, 1983, when he signed his pathology report and sent it to the family physician. Further, the court found the New York rule to be consistent with Article 1, Section 12 of the Indiana Constitution which provides, in pertinent part: "All courts shall be open; and every person, for injury done to him in his person . . . shall have remedy by due course of law."<sup>12</sup> Hence, Rinker's suit was barred as of August 11, 1985.

Because of the significance of pathology reports in analyzing potential medical malpractice claims, this decision places a large burden on Indiana practitioners and their patients. If there has been an error committed by a medical laboratory or a hospital pathology department, this error oftentimes is not discovered until more than two years after the report. Treating physicians who rely on an erroneous pathology report should not be held responsible for the report's errors where the treating physician has no reason to doubt the validity of the report. However, this leaves no recourse for the victim of a diagnostician's negligence where the errors are not found until two years or longer after the diagnostician's last report.

A more equitable limitations of action policy would be to allow medical malpractice actions to be brought within two years following the discovery of the negligent act or the discovery of information which, in the exercise of reasonable diligence, would lead to discovery of the malpractice. This could be combined with the current absolute "occurrence" rule, however, for a longer period of time. One suggestion is seven years, which is the time period a physician is required to maintain medical records for a patient.<sup>13</sup> Thus, most actions would have to be brought within two years of the date of the negligent act. Where the negligent act could not have been discovered, even with due diligence, until a later time, the patient would be given up to seven years from the date of the negligent act to bring his action. Because the Indiana Medical Malpractice Act specifically addresses the question of limitations of action,<sup>14</sup> legislative action will be required to alleviate the harshness of the current law.

### *B. Corporations as Health Care Providers*

In *Sloan v. Metropolitan Health Counsel of Indianapolis, Inc.*,<sup>15</sup> decided December 23, 1987, the court of appeals reversed the long-standing principle of Indiana law that a corporation cannot practice medicine and therefore cannot be vicariously liable for the malpractice

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12. IND. CONST. ART I, § 12.

13. IND. CODE § 16-4-8-12 (1988).

14. IND. CODE § 16-9.5-3-1 (1988).

15. 516 N.E.2d 1104 (Ind. Ct. App. 1987).

of a physician in its employ.<sup>16</sup> Defendant Metro-Health Plan (Metro) is a not-for-profit corporation providing prepaid health care. Its operations are regulated under Indiana law for health maintenance organizations.<sup>17</sup> Metro physicians labor under an "employment contract;" they are paid a salary; they receive benefits; and their practice is subject to review by a medical director physician, who also determines medical policy matters for the corporation.

Plaintiff Sloan brought an action against Metro alleging negligent failure to diagnose. Defendant Metro invoked the jurisdiction of the trial court pursuant to Indiana Code section 16-9.5-10-1. The trial court granted summary judgment to Metro on the theory that a corporation cannot be vicariously liable for the malpractice of a physician in its employ. The court of appeals reversed, holding "where the usual requisites of agency or an employer/employee relationship exist, a corporation may be held vicariously liable for malpractice for acts of its employee/physicians."<sup>18</sup>

A long line of Indiana decisions prior to *Sloan* held that because no Indiana statute existed permitting corporations to practice medicine, a public policy prohibited corporations from practicing medicine.<sup>19</sup> These cases ruled that the doctrine of *respondeat superior* was inapplicable where employees of a corporation were medical practitioners.<sup>20</sup> In *Sloan*, the court found this reasoning to be illogical, and if any such public policy ever existed, it was abolished by the Professional Corporation Act of 1983.<sup>21</sup>

The court explained its holding by embracing the reasoning of *Estate of Mathes v. Ireland*.<sup>22</sup> In *Mathes*, the court recognized that many physicians hold staff privileges at one or more hospitals, and their mere treatment of a patient at a given hospital does not give rise to hospital liability for any negligence on the part of the physician. However, the court further reasoned:

[W]e find no logical basis for denying liability under proper circumstances on the ground that the professional must exercise a professional judgment that the principal may not properly control. The general rule of liability that presupposes *authorization* of acts of the agent in order to bind the principal applies

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16. See *Interman v. Baker*, 214 Ind. 308, 15 N.E.2d 365 (1938); *South Bend Osteopathic Hosp. Inc. v. Phillips*, 411 N.E.2d 387 (Ind. Ct. App. 1980).

17. IND. CODE §§ 27-8-7-1 to -21 (1988).

18. *Sloan*, 516 N.E.2d at 1109.

19. See cases cited *supra* note 16.

20. See cases cited *supra* note 16.

21. *Sloan*, 516 N.E.2d at 1109 (citing IND. CODE § 23-1.5-1-1 (1988)).

22. 419 N.E.2d 782 (Ind. Ct. App. 1981).



to a principal's contractual or *non-tort* liability. The *tort* liability of the principal expressed in the doctrine of respondeat superior is based not upon the agency relationship (authorization or ratification) but upon the employer-employee relationship. Thus, the touchstone of the principal's liability for the tortious acts of his agent is merely whether they are done within the course and scope of the employment.<sup>23</sup>

In future decisions, the courts will no doubt be asked to explain exactly what relationships will give rise to the application of the doctrine of *respondeat superior* in the health care field. For example, are hospitals responsible for the negligent acts of emergency room physicians who contract with the hospital, who are paid a salary, and who are subject to professional reviews by the medical director of the hospital? These are some of the critical questions left unanswered by *Sloan*.

*C. Actions Where One Defendant Is a "Qualified Health Care Provider" and Others Are Not So "Qualified"*

The Indiana Medical Malpractice Act requires each person who has a claim against a health care provider, qualified for the Act's protections,<sup>24</sup> to first file a proposed complaint with the Indiana Insurance Commissioner.<sup>25</sup> A panel of health care providers is then formed, and the panel issues a professional opinion based on its review of medical records and other documentation provided to the panel by the parties. All this is a prerequisite to filing a medical malpractice action against a health care provider who is "qualified" under the Act.<sup>26</sup> The Act does not address the question of what happens when multiple defendants are sued and one or more of the defendants is not a "qualified health care provider."

In *State ex rel. Hiland v. Fountain Circuit Court*,<sup>27</sup> the Indiana Supreme Court shed significant light on this question. In *Hiland*, plaintiffs brought an action against a qualified health care provider, Manual Cacdac, M.D., and others who were not qualified for the protections

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23. *Sloan*, 516 N.E.2d at 1109 (quoting *Estate of Mathes v. Ireland*, 419 N.E.2d 782 (Ind. Ct. App. 1981) (emphasis in original) (citations omitted)).

24. "Qualified health care providers" are those who meet the requirements of the Act by purchasing professional liability insurance, contributing to the Indiana Patient Compensation Fund and complying with other provisions of Ind. Code section 16-9.5-2-1 (1988). The benefits for being "qualified" include a limitation of liability or "exposure" to \$100,000.00 for each incident pursuant to Ind. Code section 16-9.5-2-2 (1988).

25. IND. CODE § 16-9.5-9-1 (1988).

26. IND. CODE § 16-9.5-9-2 (1988).

27. 516 N.E.2d 50 (Ind. 1987).

of the Indiana Medical Malpractice Act. On the same day, a proposed complaint against Dr. Cacdac was filed by Hiland with the Indiana Insurance Commissioner. Hiland sought a court order imposing a stay upon all proceedings against Cacdac in the state court action until after the medical review panel had rendered its decision. Cacdac moved to dismiss the complaint against him and objected to any participation in striking of counties pursuant to codefendant's Motion for Change of Venue. The court of appeals found that Indiana Code sections 6-9.5-10-1, -2 specifically authorized resolution of change of venue matters as a "preliminary determination" for which the trial court had limited subject matter jurisdiction.<sup>28</sup> The court further stated, "In addition to these purposes, we observe that just and efficient judicial administration is not served by the sanctioning of a procedure that unnecessarily requires duplicitous multiple trials of the same factual issues, nor by inviting the prospect of inconsistent and contradictory verdicts."<sup>29</sup>

Thus, the court approved the practice in multiple defendant actions to keep the entire case together in order to avoid needless expense and additional burden on the courts. This ruling, coupled with the provisions of Indiana Code section 34-4-33-11,<sup>30</sup> gives Indiana practitioners an outline of how to proceed in such cases. First, the lawsuit against both qualified and non-qualified defendants is filed with the trial court. At the same time, a proposed complaint is filed against the qualified health care providers with the Indiana Insurance Commissioner. Next, the trial court may make preliminary determinations regarding matters such as venue. The trial court is required to grant reasonable delays until the medical review panel procedure has been completed as to the qualified health care providers.<sup>31</sup> After the panel has rendered its opinion in the claim against the qualified health care provider, the trial court is required to resume proceedings involving the qualified health care providers as

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28. *Id.* at 51.

29. *Id.* at 52.

30. IND. CODE § 34-4-33-11 (1988) in entirety provides:

Sec. 11. When an action based on fault is brought by the claimant against one (1) or more defendants who are qualified health care providers under IC 16-9.5, and, also is brought by suit against one (1) or more defendants who are not qualified health care providers, upon application of the claimant, the trial court shall grant reasonable delays in the action brought against those defendants who are not qualified health care providers until the medical review panel procedure can be completed as to the qualified health care providers. When an action is permitted to be filed against the qualified health care providers, the trial court shall permit a joinder of the qualified health care providers as additional defendants in the action on file against the nonhealth care providers.

31. *Id.*



additional defendants in the action on file against the other defendants.<sup>32</sup>

#### *D. Damages and Preexisting Conditions*

With the exception of some "unnecessary treatment" cases, almost every medical malpractice case involves a preexisting illness or medical condition. In *Dunn v. Cadiente*,<sup>33</sup> the Indiana Supreme Court discussed plaintiff's burden of proof on damages where there is a preexisting medical condition in existence before intervention by a defendant health care provider. In *Dunn*, plaintiff appealed a trial court award of \$24,065 in damages. The court of appeals reversed, finding the judgment clearly erroneous because the evidence at trial showed medical expenses to be no less than \$65,700 and future loss of earnings to be in excess of \$600,000.<sup>34</sup> The Indiana Supreme Court reversed.<sup>35</sup>

The court affirmed the principle that the preexisting condition or susceptibility, if aggravated by defendant's conduct, may result in defendant's full liability for resulting injury and loss.<sup>36</sup> However, if the preexisting condition, standing alone, independently causes injury and loss, then defendant will not be liable for those damages.<sup>37</sup> The court pointed to testimony of the plaintiff's medical expert that the resulting impairment was to some extent inevitable notwithstanding the alleged negligence of defendant.<sup>38</sup>

What distinguishes Justice Dickson's opinion from earlier case law is his analysis of the parties' burdens of proof where there is an illness or medical condition before negligent treatment by a health care provider defendant. The court first adopted the reasoning of Professor Prosser:

Where a logical basis can be found for some rough practical apportionment, which limits a defendant's liability to that part of the harm which he has in fact caused, it may be expected that the division will be made. Where no such basis can be

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32. *Id.* This statute uses the term "joinder" for the procedure of resuming proceedings after the delays necessary for the medical review panel to render its opinion. However, a true joinder of parties as contemplated by Trial Rule 20 of the Indiana Rules of Trial Procedure is a slightly different concept. T.R. 20 outlines which persons may be included as parties plaintiff or defendant in one lawsuit. The statute discussed here, on the other hand, describes a procedure for keeping all defendants in one lawsuit where some, but not all, are covered by the protections and additional procedural requirements of the Act.

33. 516 N.E.2d 52 (Ind. 1987).

34. *Dunn v. Cadiente*, 503 N.E.2d 915 (Ind. Ct. App. 1987).

35. 516 N.E.2d at 57.

36. *Id.* at 56.

37. *Id.*

38. *Id.*

found and any division must be purely arbitrary, there is no practical course except to hold the defendant for the entire loss, notwithstanding the fact that other causes have contributed to it.<sup>39</sup>

Thus, where there is no basis for apportioning defendant's liability to that part of the harm which he had in fact caused, then the defendant will be held liable for the entire loss, notwithstanding the fact that other causes have contributed to it. However, the court placed the burden of proof on the plaintiff to show the absence of any such basis for apportionment.<sup>40</sup>

The decision appears to put claimants in most medical malpractice cases in the position of being required to "prove a negative," *i.e.*, the *absence* of a basis for apportionment of damages. This raises a number of questions. Is expert testimony required? How is the jury to be instructed on this question? The practical application of this burden of proof in medical malpractice trials will be difficult.

*E. Jones v. Griffith: New Insights on the Authority of Trial Courts over Medical Review Panels*

The opinion by the United States District Court for the Northern District of Indiana in *Jones v. Griffith*<sup>41</sup> is remarkable in several respects. First, the entry includes an order from the federal trial court to an Indiana medical review panel to render a specific finding under Indiana Code section 16-9.5-9-7(c).<sup>42</sup> Second, the court found that the standard of care for "informed consent" cases necessarily is dependent both on expert opinion and questions of fact requiring lay witness testimony. Third, the court defined the term "factor" used in Indiana Code section 16-9.5-9-7(e) and distinguishes that term from the phrase "substantial factor" as that phrase is used under Indiana law to define the standard for proximate cause in medical malpractice cases.

Plaintiff Carol Jones was the personal representative of the estate of Jon W. Jones, who died following a femoral angiographic procedure performed by defendant Harold M. Griffith, M.D. The procedure involved injection of contrast media into the patient's vascular system, and it appeared Mr. Jones had an anaphylatic reaction to the angiographic

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39. *Dunn*, 516 N.E.2d at 56 (quoting W. PROSSER, HANDBOOK OF THE LAW OF TORTS, 314 (4th ed. 1971)).

40. *Id.*

41. 688 F. Supp. 446 (N.D. Ind. 1988) (Lee, J.).

42. *Id.* at 462 "The court directed the medical review panel to find in the words of the statute "that there is a material issue of fact, not requiring expert opinion, bearing on liability for consideration by the court or jury." IND. CODE § 16-9.5-9-7(c) (1988).



dye contract material. Mr. Jones was not told about any of the risks of the procedure. Plaintiff's claims were based on both lack of "informed consent" and negligence in responding to Mr. Jones' anaphylatic reaction. A proposed complaint was filed naming both Dr. Griffith and Parkview Memorial Hospital as defendants, both of whom were "qualified" health care providers under the Act.<sup>43</sup> The hospital was dismissed, leaving Dr. Griffith as the sole defendant.

A medical review panel was formed in accordance with the Act, and plaintiff filed in federal district court a copy of the proposed complaint and a written motion seeking a preliminary determination in accordance with Indiana Code section 16-9.5-10-1.<sup>44</sup> In the motion for preliminary determination, the plaintiff sought rulings on two issues. First, the court was asked to find that the appropriate standard for informed consent under Indiana law necessarily involves issues of fact not requiring expert opinion. Second, plaintiff asked the court to determine that the phrase "a factor" in Indiana Code section 16-9.5-9-7(d) means something different from the phrase "substantial factor" as that phrase describes the standard for proximate cause in negligence cases.

The court first dealt with questions relating to its jurisdiction to rule on plaintiff's motion. Under Indiana Code section 16-9.5-10-1, the parties may file a copy of the proposed complaint and a written motion seeking a preliminary determination of an issue of fact or law. The statute requires the moving party or his attorney to serve by summons the Indiana Commissioner of Insurance, each non-moving party to the proceeding, and the chairman of the medical review panel.<sup>45</sup> Because

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43. IND. CODE § 16-9.5-9-7(c) (1988). *See also supra* note 24.

44. IND. CODE section 16-9.5-10-1 provides:

A court having jurisdiction over the subject matter and the parties to a proposed complaint filed with the commissioner under this article may, upon the filing of a copy of the proposed complaint and a written motion under this chapter, (1) preliminarily determine any affirmative defense or issue of law or fact that may be preliminarily determined under the Indiana Rules of Procedure; or (2) compel discovery in accordance with the Indiana Rules of Procedure; or (3) both. The court has no jurisdiction to rule preliminarily upon any affirmative defense or issue of law or fact reserved for written opinion by the medical review panel under I.C. § 16-9.5-9-7(a), (b) and (d). The court has jurisdiction to entertain a motion filed under this chapter only during that period of time after a proposed complaint is filed with the commissioner under this article but before the medical review panel renders its written opinion under I.C. § 16-9.6-9-7. The failure of any party to move for a preliminary determination or to compel discovery under this chapter before the medical review panel renders its written opinion under I.C. § 16-9.5-9-7 shall not constitute the waiver of any affirmative defense or issue of law or fact.

45. *Id.* § 16-9.5-10-2 (1988).

both the Commissioner and the panel chairman were citizens of Indiana, defendant argued that diversity jurisdiction<sup>46</sup> had been destroyed. Defendant also argued that the federal court doctrine of abstention required the court to refuse to rule on the issues presented in plaintiff's motion.

With regard to diversity jurisdiction, the court found that neither the panel chairman nor the commissioner were real parties to the controversy and therefore diversity jurisdiction was not defeated.<sup>47</sup> The court also dismissed the abstention question by observing that the issues involved in the case were difficult, "but the mere difficulty in ascertaining state law questions does not justify abstention."<sup>48</sup>

According to Judge Lee, the "informed consent" issue involved two questions. First, what is the appropriate standard of care in informed consent cases under Indiana Law? Second, can the medical review panel render an "expert opinion" regarding compliance with this standard of care, or is there a material issue of fact, not requiring expert opinion, bearing on liability for consideration by the jury?<sup>49</sup>

The informed consent doctrine is an extension of the negligence concept in the context of medical treatment. Health care providers owe a duty to patients to make a reasonable disclosure of material facts relevant to the decision which the patient is requested to make.<sup>50</sup> Judge Lee rejected defendant's argument that the standard of care in informed consent cases is based solely on what other doctors in the medical community would disclose to similar patients.<sup>51</sup>

The test for determining whether a potential peril must be divulged was its materiality to the patient's decision.<sup>52</sup> All risks potentially affecting the decision must be unmasked. The court held that the risks involved and the type of potential harm in question were issues requiring expert opinion; however, lay witness testimony could establish what a reasonable patient would want to know.<sup>53</sup>

The court found that the question of informed consent necessarily involves some issues that require expert opinion and other issues where

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46. 28 U.S.C. § 1332 (1982).

47. *Jones*, 688 F. Supp. at 452. 28 U.S.C. § 1332 requires complete diversity among the parties.

48. *Jones*, 688 F. Supp. at 454. *See also* *Meredith v. City of Winterhaven*, 320 U.S. 228 (1943).

49. *Jones*, 688 F. Supp. at 455.

50. *Joy v. Chau*, 377 N.E.2d 670 (Ind. Ct. App. 1978); *Natanson v. Kline*, 350 P.2d 1093 (Kan. 1960).

51. *Jones*, 688 F. Supp. at 457-58.

52. *Id.* at 456. *See also* *Canterbury v. Spence*, 464 F.2d 772 (D.C. Cir.), *cert. denied*, 409 U.S. 1064 (1972); *Revord v. Russell*, 401 N.E.2d 763 (Ind. Ct. App. 1980); *Cobbs v. Grant*, 502 P.2d 1 (Cal. 1972).

53. 688 F. Supp. at 457.



expert opinion is not needed. The patient's right of self decision can be exercised effectively only if the patient possesses adequate information to enable an intelligent choice.

The court then reviewed the options available for the panel under Indiana Code section 16-9.5-9-7, which gives medical review panels the choice of rendering one or more of four expert opinions.<sup>54</sup> The court found that because there clearly were material issues of fact not requiring expert opinion which bear on the issue of liability, the court held that the medical review panel was bound to issue its opinion under Subsection (c) of Indiana Code section 16-9.5-9-7.<sup>55</sup>

The court then turned to the second aspect of plaintiff's motion. The court was asked to determine that the phrase "a factor" in Indiana Code section 16-9.5-9-7(d) means something different from the phrase "substantial factor" as the phrase is used in Indiana law. Indiana Code section 16-9.5-9-7(d) defines the standard for proximate cause in negligence cases. The court agreed with plaintiff's argument that the Indiana Legislature's use of the phrase "a factor" indicated a lower threshold of proof for causation than the "substantial factor" test.<sup>56</sup> The court found the plain meaning of the term to be unambiguously, "any of the circumstances, conditions, etc. that bring about a result."<sup>57</sup> Judge Lee declined plaintiff's invitation to define "a factor" as "any increase in risk of harm or decrease in chance of survival" which is used in some

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54. IND. CODE § 16-9.5-9-7 (1988). This section reads:

The panel shall have the sole duty to express its expert opinion as to whether or not the evidence supports the conclusion that the defendant or defendants acted or failed to act within the appropriate standards of care as charged in the complaint. After reviewing all evidence and after any examination of the panel by counsel representing either party, the panel shall, within thirty (30) days, render one or more of the following expert opinions which shall be in writing and signed by the panelists:

- (a) The evidence supports the conclusion that the defendant or defendants failed to comply with the appropriate standard of care as charged in the complaint.
- (b) The evidence does not support the conclusion that the defendant or defendants failed to meet the applicable standard of care as charged in the complaint.
- (c) That there is a material issue of fact, not requiring expert opinion, bearing on liability for consideration by the court or jury.
- (d) The conduct complained of was or was not a factor of the resultant damages. If so, whether the plaintiff suffered: (1) any disability and the extent and duration of the disability, and (2) any permanent impairment and the percentage of the impairment.

55. 688 F. Supp. at 460.

56. *Id.* at 461.

57. *Id.* See also Webster's New World Dictionary (2d College ed. 1978); Black's Law Dictionary (5th ed. 1979).

jurisdictions.<sup>58</sup> The court instructed the medical review panel, "Dr. Griffith's conduct was a factor if it was a circumstance or condition that brought about Jones' death. The panel is further instructed that it is not to determine whether Dr. Griffith's conduct was a 'substantial factor.' That is a matter for the jury."<sup>59</sup>

Judge Lee found authority for his order in Indiana Code section 16-9.5-10-1 as interpreted in *Johnson v. Padilla*.<sup>60</sup> In *Johnson*, the plaintiff alleged that the defendant doctor negligently performed a dilation and curettage. Before the medical review panel had issued its expert opinion, the court made a preliminary determination that Dr. Padilla was not the treating physician and rendered summary judgment for defendant.<sup>61</sup> Judge Lee reasoned that if a court can grant summary judgment in cases like *Johnson*, it can instruct the panel to make a finding that there is a factual dispute.<sup>62</sup>

The *Jones* ruling is helpful in distinguishing which issues are suitable for expert opinion in "informed consent" cases. It is also significant because it is the first case where a court ordered a medical review panel to make a certain finding. However, the significance of that aspect of the case will probably be limited to informed consent cases where material factual issues are in dispute.

In contrast, the court's definition of the term "a factor" will likely have a more far-reaching effect. Chairmen of medical review panels can instruct the health care provider members of the newly clarified definition of the term "factor." And it may be somewhat easier for medical review panels to find in favor of claimants because "factor" presents a lower standard than "substantial factor." However, it is still unclear after *Jones* what evidence is needed to create a jury question on causation where plaintiffs have no other expert opinion than the medical review panel opinion.

### III. LEGISLATION

The only legislative change to the Indiana Medical Malpractice Act in 1988 related to Indiana Code section 16-9.5-9-3.5.<sup>63</sup> New subsections were added to address the problems of panel chairman or health care

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58. *Jones*, 688 F. Supp. at 462. See, e.g., Annotation, *Medical Malpractice: "Loss of Chance" Causality*, 54 A.L.R. 4th 10 (1987).

59. 688 F. Supp. at 462.

60. 433 N.E.2d 393 (Ind. Ct. App. 1982).

61. *Id.* at 395-96. The court found that the language of Indiana Code section 16-9.4-10-1 provides that courts may preliminarily rule on factual issues contained in Indiana Code section 16-9.5-9-7(c).

62. *Jones*, 688 F. Supp. at 456-60.

63. IND. CODE § 16-9.5-9-3.5 (1988).



provider members who were not fulfilling their duties. Subpart (c) provides that the commissioner may replace a dilatory chairman; and subpart (d) provides that the chairman may remove dilatory panel members. Both the chairman and the panel member have to be replaced in accordance with section 3 of the Act.<sup>64</sup>

In order to obtain a ruling from the Indiana Insurance Commissioner that a panel chairman should be removed, a written petition will likely be required.<sup>65</sup> The petition should be verified and set forth the reasons why a new panel chairman is needed.<sup>66</sup>

Other than this relatively minor change, the Indiana Legislature was silent on medical malpractice questions despite a significant need to make adjustments in the Act. The hardships imposed by the strict "occurrence" rule for the limitations of actions should be alleviated.<sup>67</sup> An important change would be to increase the maximum amount of recovery for medical costs permitted by statute.<sup>68</sup> Assuming that \$500,000 was a rational limit in 1975, the year the Act was passed, it no longer is reasonably related to medical costs. Medical costs in 1986 were 257% greater than what they were in 1975.<sup>69</sup> Hospital room costs are 318% of 1975 costs.<sup>70</sup> The costs for medical care have increased at approximately one and one-half times the rate of the consumer price index during that eleven-year period.<sup>71</sup> As time without legislative action goes by, more and more cases involving catastrophic injuries are or will be resolved with the claimant obtaining the maximum recoverable, but with an award which is insufficient to pay for past and future medical costs caused by the health care provider's negligence.

The current legislative scheme providing for a maximum recoverable amount is overly simplistic. First, the Act was the legislature's response to a "crisis."<sup>72</sup> Whether the crisis was real or imagined, the legislature opted to make certain that medical care would be provided. The situation the legislature sought to avoid was the non-existence of medical care or

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64. *Id.* § 16-9.5-9-3.

65. Interview with Mrs. Marsha Harrison-Pitcher, Indiana Insurance Commissioner, Patient Compensation Fund (August 1, 1988) (the Commission has not as yet adopted formal rules to carry out its responsibilities under Indiana Code section 16-9.5-9-3.5).

66. *Id.*

67. *See supra* text accompanying notes 13-14.

68. IND. CODE § 16-9.5-2-1 (1988).

69. Statistics from Terrance C. Parks, Ph.D., Professor of Economics, Indiana State University, based on data published in STATISTICAL ABSTRACT OF THE UNITED STATES, BUREAU OF CENSUS, U.S. DEPARTMENT OF COMMERCE (108th ed. 1988).

70. *Id.*

71. *Id.*

72. *Johnson v. St. Vincent Hosp., Inc.*, 273 Ind. 374, 399-400, 404 N.E.2d 585, 599 (1980) (the court held the Indiana Act constitutional).

practitioners acting without insurance.<sup>73</sup> The cap on the amount recoverable in a medical malpractice action was supposed to alleviate the problems associated with the uninsured practice of medicine and/or no medical care at all.<sup>74</sup> However, problems apparent on the face of the Act were not considered. Most notably, there is no formula for determining when the "crisis" has ended. Thus, the harsh result originally imposed on the patients most seriously injured by medical malpractice has now become oppressive and dramatically outweighs any benefit derived from maintaining the Act.

The reason why the Act should be abolished or altered is that statutory caps are a drastic measure which should only be instituted when there is no other solution. A statutory cap should never be a permanent solution; it should only be used in a critical situation and should be maintained only temporarily until another solution can be found. Indiana maintains the harshest statutory cap of any state in the United States.<sup>75</sup> It is noteworthy that statutory caps have fallen into disfavor in a growing number of states. Texas and Virginia courts have

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73. *Id.*

74. *Id.*

75. ALASKA STAT. § 09.17.010 (1986) (\$500,000 limit for noneconomic damages in personal injury actions, not including disfigurement or severe physical impairment); CAL. CIV. CODE § 3333.2 (West 1975) (\$250,000 limit for noneconomic damages in medical malpractice cases); COLO. REV. STAT. § 13-21-102.5 (1986) (\$250,000 limit for noneconomic damages generally, \$500,000 limit for noneconomic damages where there is clear and convincing evidence which justifies such a finding by the court); HAW. REV. STAT. § 663-8.5, -8.7 (1986) (\$375,000 limit for pain and suffering, distinguished from other noneconomic damages of mental anguish, disfigurement, loss of enjoyment of life, loss of consortium, and other pecuniary losses or claims); IND. CODE ANN. § 16-9.5-2-2 (Burns, 1975) (\$500,000 limit on all damages recoverable for injuries in a medical malpractice action); KAN. STAT. ANN. § 60-340 (1986) (\$250,000 limit on noneconomic damages in medical malpractice cases); LA. REV. STAT. ANN. § 40:1299.39 (West 1986) (\$500,000 limit on all damages except medical expenses); MD. CTS. & JUD. PROC. CODE ANN. § 11-108 (1987) (\$350,000 limit on noneconomic damages in any action for personal injury); MASS. GEN. LAWS ANN. ch. 231, § 60H (West 1986) (\$500,000 limit for noneconomic damages in medical malpractice actions—does not apply to wrongful death actions); MICH. COMP. LAWS § 600.1583 (1986) (\$225,000 limit for noneconomic damages in medical malpractice cases); MINN. STAT. § 549.23 (1986) (\$400,000 limit on embarrassment, emotional distress, and loss of consortium); MO. REV. STAT. § 538.210 (1986) (\$350,000 limit for noneconomic damages in medical malpractice cases); NEB. REV. STAT. § 44-2825 (1984) (\$1,000,000 limit on all damages in medical malpractice cases); N.H. REV. STAT. ANN. § 508:4-d (1986) (\$875,000 limit on noneconomic damages for personal injury cases); S.D. CODIFIED LAWS ANN. § 21-3-11 (1986) (\$1,000,000 limit for all damages in medical malpractice cases); UTAH CODE ANN. § 78-14-7.1 (1987) (\$250,000 limit on noneconomic damages in medical malpractice cases); WASH. REV. CODE § 4.56.250 (1986) (variable cap on noneconomic damages for personal injury cases); W. VA. CODE § 55-78-8 (1986) (\$1,000,000 for noneconomic damages in medical malpractice cases); WIS. STAT. § 893.55 (1986) (\$1,000,000 limit for noneconomic damages in medical malpractice cases).



recently struck down caps on tort recovery.<sup>76</sup> Florida courts have struck down caps as unconstitutionally overbroad when not aimed at a specific crisis concerning compelling state interests,<sup>77</sup> even though the state had an insurance crises far worse than faced by Indiana.<sup>78</sup> Louisiana modified its statutory cap in medical malpractice cases, based on Indiana's Act, to allow plaintiffs to recover full medical expenses.<sup>79</sup>

An approach which would be better suited to the needs of each individual case, if a cap is still necessary, would be to provide for no maximum dollar amount for past and future medical expenses and lost earnings or earning capacity. A maximum could be set on pain, suffering and mental anguish. A cap on the "intangible" award would more fairly distribute the economic burden involved in medical malpractice cases while fulfilling the same policy goals underlying the current Act. Insurance carriers could reasonably predict their liability for the quantifiable tangible losses, such as medical costs and lost wage and earnings capacity. It would remove the unquantifiable variable of intangible loss. Seriously injured victims of medical malpractice would not have to bear the economic burden of medical costs not recoverable under the current Act. Finally, few Indiana medical malpractice cases are tried to a jury, but this scheme would prevent juries (or judges in bench trials) from "running away" and awarding excessive verdicts based on the more intangible elements of the claimant's damages.

#### IV. CONCLUSION

Although some questions were answered by the Indiana courts and legislature during the survey period, new issues remain which require future action both by the courts and by the Legislature. In the area of limitation of medical malpractice actions, what is the best way to alleviate

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76. *Detar Hosp., Inc. v. Estrada*, 694 S.W.2d 359 (Tex. 1985), (invalidating TEX. REV. CIV. STAT. ANN. art. 4590: §§ 11.01-11.05 (Vernon Supp. 1985)); *Boyd v. Bulala*, 647 F. Supp. 781 (1986) (invalidating VA. CODE ANN. § 8.01-581.15 (1983)).

77. *Smith v. Department of Ins.*, 507 So. 2d 1080 (Fla. 1987) (invalidating FLA. STAT. ANN. § 768.80 (West 1986)).

78. See Shulte, *Availability, Affordability, and Accountability: Regulatory Reform of Insurance*, 14 FLA. ST. U. L. REV. 557 (1986).

79. LA. REV. STAT. ANN. § 40:129939 (West 1986). The change was a response to *Sibely v. Board of Sup'rs. of Louisiana*, 462 So. 2d 149 (La. 1985). In *Sibely*, the Louisiana Supreme Court upheld the constitutionality of the flat cap. The only issue the Court addressed concerned the constitutionality of the \$500,000 limit on recovery in medical malpractice cases. Liability had already been definitively established. At the time of the trial, the plaintiff's medical expenses already exceeded \$423,000. The injuries did not alter her life expectancy—she had been preparing for college at the time of the malpractice. After the malpractice, she would never achieve a significant degree of self sufficiency and faced the life-long costs of custodial care. *Id.*

the harshness of the strict "occurrence" rule in some situations? In which specific situations will the courts find that the doctrine of *respondeat superior* applies to corporate health care providers? In cases where "qualified" health care providers are co-defendants with others who are not protected by the Act, how will the courts deal with the non-"qualified" defendants who are prejudiced by the delays necessary to keep all defendants in one case? What testimony and other evidence will carry plaintiff's burden to show the absence of any basis for apportioning damages caused by the defendant in cases involving pre-existing illness? In the face of rising costs of medical care, what adjustments should be made in the Act's limitations on damages for claimants? Each of these issues present fertile ground for future legislative initiative and judicial resolution regarding medical malpractice law in Indiana.





# Worker's Compensation

ROBERT A. FANNING\*

The practice of worker's compensation law in Indiana has seen significant change in 1988. In the short session of the Indiana General Assembly, the Worker's Compensation Act was the subject of unprecedented debate. In the courts, the ramifications of the *Evans v. Yankeeetown Dock Corp.*<sup>1</sup> decision were still being felt as refinement of case law occurred.

## I. SIGNIFICANT STATUTORY CHANGES

At least fourteen specific provisions of the Indiana Worker's Compensation Act were legislatively revised in 1988 by way of Senate Enrolled Act No. 402 and House Enrolled Act No. 1069.<sup>2</sup> In addition, numerous technical changes were made throughout the Act and other statutes where reference to the Act is made. The following is a discussion of the most significant revisions.

### A. Benefit Changes

Of most significance to employees and employers in the State of Indiana were increases for temporary total disability benefits equaling approximately 55% over three years<sup>3</sup> and increases for permanent partial impairment benefits equaling approximately 60% over three years.<sup>4</sup> Employers and employees alike agreed with legislators that significant increases in benefit rates were reasonable and necessary. Of course, such benefit increases are not without cost. It is estimated that Indiana employers will see worker's compensation insurance rates rise approximately 27% overall in 1988, 10% of which can be directly attributed to legislative action.<sup>5</sup>

1. *Temporary Total Disability.*—The statutory method for computing temporary total disability benefits remains unchanged from previous law, with the benefit equaling two-thirds of an employee's average

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\* Partner, Locke, Reynolds, Boyd & Weisell, Indianapolis. B.S., Indiana University, 1973; J.D., Indiana University School of Law—Indianapolis, 1976.

1. 491 N.E.2d 969 (Ind. 1986).

2. See *infra* app. I at p. 570.

3. IND. CODE §§ 22-3-3-22, -7-19 (1988).

4. *Id.* §§ 22-3-3-10, -7-16.

5. See Indiana Compensation Rating Bureau Rate Request, filed July 1, 1988, with the Indiana Department of Insurance.



weekly wage up to a statutorily mandated maximum average weekly wage. For accidents occurring on and after July 1, 1988, however, the maximum average weekly wage to be used for the purpose of computing temporary total disability benefits is \$384 per week.<sup>6</sup> The maximum temporary total disability benefit is therefore computed by multiplying two-thirds by \$384 to achieve a maximum benefit of \$256 per week. The temporary total disability benefit for an employee earning less than \$384 per week is arrived at by multiplying the employee's actual average weekly wage, subject to a \$75 per week minimum, by two-thirds, which will result in a temporary total disability benefit of something less than \$256 per week. An employee who is earning in excess of the maximum average weekly wage may receive, or in the event of his death his dependents may receive, a maximum of \$128,000 for compensation or death benefits.<sup>7</sup>

The Indiana General Assembly prospectively increased the temporary total disability benefit by establishing increased maximum average weekly wage figures for 1989 and 1990. On and after July 1, 1989, the maximum average weekly wage will be deemed to be \$411 per week, which will result in a maximum temporary total disability benefit of \$274 per week and a maximum combined compensation or death benefit of \$137,000. On and after July 1, 1990, the maximum average weekly wage rises to \$441 per week leading to a maximum benefit for temporary total disability of \$294 per week and a maximum compensation or death benefit of \$147,000.<sup>8</sup>

2. *Permanent Partial Impairment.*—The increase in permanent partial impairment benefits is the first since 1977. As in prior law, the maximum average weekly wage and the percentage factor to be applied for the purpose of computing the permanent partial impairment benefit are different from those used to figure temporary total disability benefits.<sup>9</sup> For accidents occurring on and after July 1, 1988, the maximum average weekly wage for permanent partial impairment purposes is \$166 per week. Application of the statutory 60% factor results in a maximum permanent partial impairment benefit of \$99.60 per week. If an average weekly wage of less than \$166 per week is earned, the permanent partial impairment benefit is equal to 60% of the employee's actual average weekly wage.<sup>10</sup>

As with temporary total disability, permanent partial impairment benefits will increase in 1989 and 1990. On and after July 1, 1989, the

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6. IND. CODE §§ 22-3-3-22(a), -7-19(a)(1) (1988).

7. *Id.* §§ 22-3-3-22(a), -7-19(h).

8. *Id.* §§ 22-3-3-22(a)(b), -7-19(g)(1), -7-19(j).

9. *See id.* §§ 22-3-3-10(a), -7-16(d).

10. *Id.*

maximum average weekly wage for permanent partial impairment purposes increases to \$183 per week, which results in a maximum permanent partial impairment benefit of \$109.80.<sup>11</sup> On and after July 1, 1990, the maximum average weekly wage for impairment purposes rises to \$200 per week, resulting in a maximum permanent partial impairment benefit of \$120 per week.<sup>12</sup>

3. *Credit for Excess Temporary Total Disability Benefits Paid.*—Effective July 1, 1988, the employer's credit for temporary total disability benefits paid in excess of fifty-two weeks has been changed so that the credit applies only after temporary total disability benefits have been paid for more than seventy-eight weeks.<sup>13</sup> As with prior law, the credit is applied against permanent partial impairment benefits and benefits paid for specific losses and reduces such benefits dollar for dollar. The net effect of the statutory change is to increase the permanent partial impairment benefit for those employees who are temporarily totally disabled by their work-related injuries for more than fifty-two weeks. As an example, an employee who was injured on July 1, 1988, was temporarily totally disabled for seventy-eight weeks, was receiving temporary total disability compensation at the maximum rate and was assigned a 20% permanent partial impairment of the whole person, would receive a permanent partial impairment award of \$9,960.<sup>14</sup> The same employee injured after July 1, 1986, and before July 1, 1988, would receive a permanent partial impairment award of \$2,560.<sup>15</sup> Thus, for the employee who is disabled a year or more, the combination of an increased permanent partial impairment benefit and a reduced credit for excess temporary total disability paid makes a significant difference in the compensation received for a permanent partial impairment or scheduled loss.

4. *Burial Expense.*—The provision of the Indiana Worker's Compensation Act calling for the payment of burial expenses not to exceed \$2,000 was changed effective July 1, 1988, to allow for a payment of

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11. *Id.*

12. *Id.* For tables outlining average weekly wage minimums, maximums and resulting benefits, see *infra* app. II at p. 573.

13. IND. CODE §§ 22-3-3-10(a), -7-16(d).

14. Five hundred weeks of whole body benefit times 20% permanent partial impairment (PPI) rating equals 100 weeks of PPI benefits times \$99.60 per week which equals \$9,960 PPI benefit.

15. Five hundred weeks of whole body benefit times 20% PPI rating equals 100 weeks of PPI benefits times \$75.00 per week which equals \$7,500 PPI benefit. Subtracting the credit for twenty-six weeks of temporary total disability benefits paid in excess of fifty-two weeks at \$190 per week equals a credit of \$4,940 and a net PPI benefit of \$2,560.



up to \$4,000.<sup>16</sup> This revision reflects the increased cost of burial and related services and comes closer to providing the full cost of a modest funeral and internment. The payment of burial expenses is not compensation for the purpose of determining the statutory maximum payment for compensation pursuant to Indiana Code sections 22-3-3-22 and 22-3-7-19, and is payable even where there are no dependents entitled to receive compensation.<sup>17</sup>

5. *Artificial Body Members.*—The employer is required to provide an artificial member, braces or prosthodontics where a compensable injury has led to the amputation of an arm, hand, leg or foot, the enucleation of an eye or the loss of natural teeth or existing prosthodontics.<sup>18</sup> New statutory language makes it clear that the employer may be required to provide more than one artificial member when “medically required.” The term “medically required” is specifically defined in the Act to exclude normal wear and tear.<sup>19</sup> Thus, an employee who has suffered the amputation of a leg and receives an artificial member may be entitled to the replacement of that member where changes in the size, shape or further treatment of the stump make necessary the fitting of a new prosthetic device. However, where the employee has satisfactorily used an artificial member and wears it out, the employee is responsible for the repair or replacement of the device.

#### B. *Notification Regarding Suspension of Benefits*

Various provisions of the Indiana Worker's Compensation Act have allowed for the suspension of benefits where the employee has refused to accept tendered medical services,<sup>20</sup> undergo medical examination,<sup>21</sup> accept tendered employment,<sup>22</sup> or where a dependent refuses to allow an autopsy to be performed.<sup>23</sup> Each of the foregoing sections of the statute have been changed effective July 1, 1988, so as to require that the employee or dependent be served with a notice setting forth the consequences of such an employee or dependent refusal. The Worker's Compensation Board was mandated under these sections to prescribe the form for such notice and, in response, the board has developed a proposed form for use by employers in this regard. The final format

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16. IND. CODE §§ 22-3-3-21, -7-15 (1988).

17. See *Lasear, Inc. v. Coffin*, 99 Ind. App. 461, 192 N.E. 841 (1934).

18. IND. CODE § 22-3-3-4(e) (1988).

19. *Id.*

20. *Id.* §§ 22-3-3-4(c), -7-17(b).

21. *Id.* §§ 22-3-3-6(a), -7-20(a).

22. *Id.* §§ 22-3-3-11(a), -7-16(e).

23. *Id.* §§ 22-3-3-6(h), -7-20(i).

and the form document itself should be available soon. As of this time, the proposed language for the form states:

NOTICE TO EMPLOYEE/DEPENDENT  
OF SUSPENSION OF BENEFITS

Notice is hereby given, pursuant to the Worker's Compensation and Occupational Disease Acts of Indiana, of the consequences of your refusal described below: (Check appropriate paragraph)

- ( ) Refusal to accept medical treatment, services and supplies, provided by or on behalf of your employer, shall bar your compensation otherwise payable during the period of refusal. (I.C. 22-3-3-4)
- ( ) Refusal to allow an autopsy shall result in a suspension of all compensation. (I.C. 22-3-3-6).
- ( ) Refusal to accept employment, suitable to your partial disability, shall bar any compensation during such refusal unless, in the opinion of the Worker's Compensation Board of Indiana, such refusal was justified. (I.C. 22-3-3-11).<sup>24</sup>

The proposed notice also contains an acknowledgment of receipt to be signed and dated by the employee or dependent. Such acknowledgement is not required by the statutory revision and the refusal of an employee to acknowledge receipt of the notification will not prevent an employer from suspending benefits. Of course, it will be inappropriate for an employer to suspend benefits until the employee has been served with the notice, and problems may develop with regard to what is adequate service. It is suggested that personal delivery to the employee or dependent or transmittal by United States mail, postage pre-paid, to the address stated on the Agreement as to Compensation (Form #12 or Form #13) will be sufficient.<sup>25</sup> This is so inasmuch as service of pleadings pursuant to Rule 5(B) of the Indiana Rules of Trial Procedure,<sup>26</sup> as incorporated by Rule 6 of the Rules of the Worker's Compensation Board of Indiana,<sup>27</sup> is complete upon delivery or service by mail. Neither the statute nor the board's proposed notice require proof of actual receipt before benefits may be suspended.

Where an employer requests an employee to submit to a physical examination, prudence dictates that the notice required by Indiana Code sections 22-3-3-6 and 22-3-7-20 be given in advance of the scheduled

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24. WORKER'S COMPENSATION BOARD OF INDIANA, NOTICE TO EMPLOYEE/DEPENDENTS: STATE FORM 42606 (May 1988).

25. *Id.*

26. IND. R. TR. P. 5(B).

27. IND. ADMIN. CODE tit. 630, r. 1-1-6 (1988).



examination if there is any possibility that the employee will refuse the same. Otherwise, if the employee fails to keep the appointment, it is likely that a second examination will have to be scheduled, with the notice being sent prior to the second examination, before the employee will be deemed to have knowledge regarding the effect of such refusal sufficient to suspend benefits.<sup>28</sup>

*C. Payment of Medical Expenses by Insurer Required Where  
Approved by Employer*

The Indiana Worker's Compensation Act defines "employer" to include, so far as is applicable, the employer's worker's compensation insurer.<sup>29</sup> The Indiana General Assembly revised the definition to also state: "However, the inclusion of an employer's insurer within this definition does not allow an employer's insurer to avoid payment for services rendered to an employee with the approval of the employer."<sup>30</sup>

The change was sought to remedy the refusal by some insurance companies to pay medical bills which were incurred by the employee at the direction or approval of the employer at a time before the insurance carrier had an opportunity to undertake the management of the medical aspects of the case. The statutory change serves to clarify the prior policy of the Worker's Compensation Board which required payment of medical expenses incurred at the direction or approval of the employer, even though the insurer would have recommended or preferred a different treatment or medical provider.

An issue which will no doubt be raised by this changed definition is whether or not the compensation insurance carrier may undertake a change of physician where the employer had previously designated a physician or approved the employee's use of a physician. In the author's opinion, the statutory change found at both Indiana Code section 22-3-6-1 and section 22-3-7-9(a) does not prohibit the insurance carrier and the employer from agreeing upon a medical provider or course of treatment other than that originally designated. This is so because the Act requires the employer to provide the medical care<sup>31</sup> but does not limit the employer's choice of a physician to one particular doctor.

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28. The proposed notice does not make specific reference to medical examinations under IND. CODE § 22-3-3-6 (1988) or *id.* § 22-3-7-20, but the notice regarding medical treatment will likely be deemed synonymous with a notice regarding medical examination.

29. IND. CODE §§ 22-3-6-1(a), -7-9(a) (1988).

30. *Id.*

31. For example, a physician is required after an injury, IND. CODE § 22-3-3-4(a) (1988), and during temporary total disability. *Id.* § 22-3-3-4(b). Further, the employee can be required to submit to an examination during the period of claimed disability or impairment. *Id.* § 22-3-3-6(a).

*D. Medical Reports as Evidence*

The practice of the Worker's Compensation Board of Indiana before July 1, 1988, was to allow medical testimony either in person, by deposition, or where all parties agreed, by the introduction of a medical report.<sup>32</sup> The unavailability of the medical provider did not need to be established as a prerequisite to the use at trial of a deposition or agreed report. In its 1988 session, the Indiana General Assembly was extensively lobbied to allow the admission of medical reports, even where the parties could not agree to stipulate their admission. The stated purpose for the change was to avoid the expense associated with obtaining medical depositions. The result has been an extensive revision of Indiana Code section 22-3-3-6, which may significantly affect practice before the Worker's Compensation Board.

In summary, the prior law provided that a physician, whether selected by the employer or the employee, was required to prepare a statement in writing of the conditions evidenced by his examination of the employee and to provide the statement to the opposing party.<sup>33</sup> The law required that the statement be exchanged as soon as practicable but not later than ten days before the date upon which the case was set for trial.<sup>34</sup> In practice, the statement was provided by the doctor to the party who had retained him, and that party's attorney exchanged the statement with opposing counsel. The physician's statement was required to contain "the history of the injury, or claimed injury, as given by the patient, the physical or mental condition of such employee, and the nature and extent or amount of disability or impairment, if any, of such employee."<sup>35</sup> If no report of an examination was exchanged as required, then the physician could not testify before the Worker's Compensation Board, either in person or by deposition, as to such examination.<sup>36</sup>

As changed, the law still requires a statement in writing from the doctor, but the exchange of the report must take place at least thirty days before the hearing and the statement must contain the following:

- (1) The history of the injury, or claimed injury, as given by the patient.
- (2) The diagnosis of the physician or surgeon concerning the patient's physical or mental condition.
- (3) The opinion of the physician or surgeon concerning the causal relationship, if any, between the injury and the pa-

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32. IND. CODE § 22-3-3-6 (1982).

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*



tient's physical or mental condition, including the physician's or surgeon's reasons for the opinion.

- (4) The opinion of the physician or surgeon concerning whether the injury or claimed injury resulted in a disability or impairment and, if so, the opinion of the physician or surgeon concerning the extent of the disability or impairment and the reasons for the opinion.
- (5) The original signature of the physician or surgeon.<sup>37</sup>

If a statement meets the five requirements of subsection (e), then it "may be submitted by either party as evidence by that physician or surgeon at a hearing before the worker's compensation board."<sup>38</sup> Such a statement shall be admitted into evidence by the Worker's Compensation Board "unless the statement is ruled inadmissible on other grounds."<sup>39</sup> Language added to the statute provides a procedure for objecting to the physician's statement on the basis that the same does not meet any or all of the five requirements of subsection (e).<sup>40</sup> A failure to object pursuant to subsection (e) precludes further objection as to whether the statement meets the requirements of subsection (e), but apparently does not waive objections to admissibility on other grounds.<sup>41</sup>

Only time will tell how well the statutory revision works. Certainly there is some question as to the "other grounds" upon which the written statement might be ruled inadmissible in light of the fact that the statute says that the written statement may be submitted and shall be admitted provided that it meets the requirements of subsection (e). The language seems to leave open the possibility that a party may submit the report if it meets the requirements of subsection (e), but the Worker's Compensation Board may not admit the report if objected to on grounds other than compliance with subsection (e). Of course, there will also be disputes as to whether or not the statement complies with subsection (e), and the party submitting the report will be at risk in that regard if he fails to correct objections raised by his opponent as to the statement's compliance with subsection (e). In many cases, medical depositions will still be taken and submitted to the Worker's Compensation Board. Even in the face of an apparently complete medical report, few parties will give up the right to cross-examine the doctor or to provide him with additional information which may lead to a more complete opinion.

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37. *Id.* § 22-3-3-6(e) (1988).

38. *Id.* § 22-3-3-6(d).

39. *Id.* § 22-3-3-6(e).

40. *Id.* § 22-3-3-6(g).

41. *Id.*

*E. Worker's Compensation Act and Worker's Compensation Board*

House Enrolled Act 1069 changes the term "workmen's compensation" to "worker's compensation" throughout the Act and renames the Industrial Board of Indiana the "Worker's Compensation Board of Indiana."<sup>42</sup> The renaming of the Industrial Board was said to be prudent because of its periodic confusion with other agencies or organizations.

II. SIGNIFICANT COURT OF APPEALS DECISIONS

*A. Ramifications of Yankeetown Definitions*

Employers, employees and insurers are still struggling with the application of the *Yankeetown*<sup>43</sup> decision to jurisdictional and compensability issues. The Supreme Court in *Yankeetown* held that questions of jurisdiction and compensability are to be determined by an application of the same criteria to each issue. Thus, the Worker's Compensation Board has jurisdiction and an employee is entitled to worker's compensation benefits where there has been an injury (1) by accident, (2) arising out of and (3) in the course of the employment. In mandating the three-part test for jurisdiction as well as for compensability, the Indiana Supreme Court felt compelled to address the definition of "by accident" and, in so doing, made clear its belief that the term "by accident" means "unexpected injury."<sup>44</sup> The unexpected injury test can be met by occurrence of either an unexpected event or an unexpected result.<sup>45</sup> Although an injury causing event such as a "fall, slip, trip, unusual exertion, malfunction of machine, break, collision, etc."<sup>46</sup> is certainly "by accident," the unexpected occurrence of a physical symptom while engaged in normal and routine employment activity without one of the above-enumerated events is also an injury by accident.<sup>47</sup> In both the event and result theories of accident, a crucial modifier is that the event or result be unexpected. It is the unexpectedness of the injury which gives employers and employees a yard stick by which to measure compensability but is also the element of the definition of "by accident" definition which is likely to lead to continued dispute with regard to both compensability and jurisdictional issues.

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42. *Id.* § 22-3-1-1(a).

43. *Evans v. Yankeetown Dock Corp.*, 491 N.E.2d 969 (Ind. 1986).

44. *Id.* at 974.

45. *Id.*

46. *Ellis v. Hubbell Metals, Inc.*, 174 Ind. App. 86, 93, 366 N.E.2d 207, 211 (1977) (enumerating the activities which could constitute an unexpected event).

47. *See Lock-Joint Tube Co. v. Brown*, 135 Ind. App. 386, 395, 191 N.E.2d 110, 114 (1963) (stating the unexpected result theory of accident).



1. *Compensability*.—The element of unexpectedness may be found in many cases reported before *Yankeetown*.<sup>48</sup> A recent application of the unexpected injury test is found in *Eastham v. Whirlpool Corp.*<sup>49</sup>

Eastham had been a long term employee of Whirlpool when, on June 14, 1982, his job was changed. On that day, he worked without complaint and made no report of an accident to his employer.<sup>50</sup> He failed to report for work for six days thereafter and, on June 21, 1982, asked to see the company doctor. The doctor saw him that day, diagnosed muscle soreness, possibly related to his new job, and released him to return to work.<sup>51</sup> Eastham did not return to work, asked for a medical leave of absence, and thereafter sought conservative medical treatment on his own.<sup>52</sup> The full Worker's Compensation Board found that Eastham's muscle soreness was not an accidental injury within the meaning of the Act because muscle soreness was to be expected during the first day or so of Eastham's new job.<sup>53</sup>

On appeal, Eastham argued that because the Worker's Compensation Board had found that he had sustained muscle soreness while doing his job, the necessary causal connection between the work and the injury was established.<sup>54</sup> The Indiana Court of Appeals pointed out, however, that before causation, *i.e.*, whether the injury arises out of the employment, need be considered, the Worker's Compensation Board must determine whether an accident occurred.<sup>55</sup> In *Eastham*, the evidence was that workers often complained of muscle soreness after starting the job in question and the court of appeals held that the full Worker's Compensation Board had correctly applied the law in determining that no unexpected injury had occurred.<sup>56</sup> In other words, because muscle soreness was to be expected the first day on the job, muscle soreness under such circumstances was not an accident.

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48. Early cases which discussed the word "accident" enunciated the requirement that the event be "unexpected." See, *e.g.*, *Haskell & Barker Car Co. v. Brown*, 67 Ind. App. 178, 187, 117 N.E. 555, 557 (1917). See also *Houchins v. J. Pierponts*, 469 N.E.2d 786, 787 (Ind. Ct. App. 1984) (In *Houchins*, the involved employee knew that certain activity would cause her knee to lock up. While engaged in that activity at work, the knee did lock up and the injury was therefore not unexpected.); *City of Anderson v. Borton*, 132 Ind. App. 684, 178 N.E.2d 904 (1961) (In *Borton*, there was evidence that Borton's back condition was such that a trivial act such as walking could cause pain. Therefore, the injury was not unexpected.).

49. 524 N.E.2d 23 (Ind. Ct. App. 1988).

50. *Id.* at 25, 27.

51. *Id.* at 25.

52. *Id.*

53. *Id.*

54. *Id.* at 27.

55. *Id.* at 28.

56. *Id.*

The holding of the court of appeals suggests that the question of unexpectedness is not necessarily to be determined from the employee's point of view.<sup>57</sup> If the Indiana Supreme Court's unexpected injury standard is to be useful, the test of unexpectedness must be an objective one, not based solely on what the employee says he expected. This is so because an employee, in expressing his subjective opinion, may be counted upon to indicate that he did not expect his injury.

In summary, "injury by accident" means unexpected injury. If the injury is caused by an unexpected event, an accident in the generally understood sense has occurred and compensability follows. Similarly, if the injury is the unexpected result of normal work activity, then an accident is deemed to have occurred, even without an outside event, and compensability must be granted. If, however, the "injury" is to be expected from a given work activity, for example, where muscle soreness or the recurrence of a pre-existing infirmity is anticipated, then an accident has not occurred and compensability must be denied.

2. *Jurisdiction and Exclusive Remedy*.—The second area where the ramifications of *Yankeetown* are being evaluated is jurisdiction and exclusive remedy. Indiana Code section 22-3-2-6 provides:

*Rights and Remedies of Employee Exclusive*—The rights and remedies granted to an employee subject to I.C. 22-3-2 through I.C. 22-3-6 on account of personal injury or death *by accident* shall exclude all other rights and remedies of such employee, his personal representatives, dependents or next of kin, at common law or otherwise, on account of such injury or death, except for remedies available under I.C. 16-7-3-6.<sup>58</sup>

Indiana Code section 22-3-2-6 suggests but *one* test for jurisdictional purposes. Thus, if an employee's claim involves personal injury or death by accident, then his exclusive remedy, as to his employer, is the Workers' Compensation Act and the proper jurisdiction for determining such claim is the Worker's Compensation Board.<sup>59</sup> The Indiana Supreme Court in *Yankeetown* held that the statute:

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57. Cf. *Inland Steel Co. v. Almodovar*, 172 Ind. App. 556, 361 N.E.2d 181 (1977), as quoted with approval in *Yankeetown*. "[T]he test as to whether an injury is unexpected and so if received on a single occasion occurs by accident' is that the sufferer did not intend or expect that injury would, on that particular occasion, result from what he was doing." *Evans v. Yankeetown Dock Corp.*, 491 N.E.2d 969, 974 (Ind. 1986) (quoting *Inland Steel Co. v. Almodovar*, 172 Ind. App. 556, 361 N.E.2d 181 (1977)).

58. IND. CODE § 22-3-2-6 (1988) (emphasis added).

59. IND. CODE § 22-3-1-2 (1988) provides that the Worker's Compensation Board has charge of the administration of the Worker's Compensation Act. IND. CODE § 22-3-1-3(b)(1) (1988) states that the Worker's Compensation Board is "authorized to hear, determine, and review all claims for compensation . . ." See *School City of Hammond v. Moriarity*, 120 Ind. App. 663, 93 N.E.2d 367 (1950).



Excludes all rights and remedies of an employee against his employer for personal injury or death if the following *three* statutory jurisdictional prerequisites are met:

- A. Personal injury or death by accident;
  - B. Personal injury or death arising out of employment;
  - C. Personal injury or death arising in the course of employment.
- Actions for employee injuries or death which do not meet each of these prerequisites are not excluded, and may be pursued in the courts.<sup>60</sup>

The Indiana Supreme Court thus disagreed with the analysis of the court of appeals,<sup>61</sup> and held that in order to determine the jurisdictional issue, a court must make an assessment as to whether the injury arose out of and in the course of the employment as well as whether it occurred by accident.

Application of the supreme court's three-part test is seen in *Consolidated Products, Inc. v. Lawrence*.<sup>62</sup> In this case, Lawrence was employed as a waitress for Consolidated which operated a 24-hour restaurant. After her shift ended at 4:00 a.m., Lawrence delayed leaving the restaurant to have a milkshake. She then went to the parking lot with another woman who was going to drive her home. The women were abducted at knife-point and Lawrence was injured.<sup>63</sup> Lawrence filed a civil action hoping to free herself of the limited financial benefits of the Act, and claimed that her injury, though by accident, did not arise out of and in the course of the employment.<sup>64</sup> Consolidated filed a motion for summary judgment contending that the Worker's Compensation Act was the exclusive remedy; therefore, the trial court was without jurisdiction.<sup>65</sup> The motion was denied and an interlocutory appeal was taken.<sup>66</sup> The court of appeals followed the step-by-step analysis found in *Yankeetown* and reversed the trial court.<sup>67</sup>

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60. *Evans v. Yankeetown Dock Corp.*, 491 N.E.2d 969, 973 (Ind. 1986) (emphasis added).

61. *Evans v. Yankeetown Dock Corp.*, 481 N.E.2d 121, 127 (Ind. Ct. App. 1986), *vacated*, 491 N.E.2d 969 (Ind. 1986). In discussing jurisdiction, the court of appeals concluded that the sole determination was whether or not an accident had occurred; if so, then the Worker's Compensation Board was the proper forum for determining whether that accident arose out of and in the course of the employment.

62. 521 N.E.2d 1327 (Ind. Ct. App. 1988).

63. *Id.* at 1328.

64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.* at 1331. Had the court of appeals affirmed the denial of the motion to dismiss, the case may well have been tried to verdict. A finding in favor of the employer

The parties had agreed that an unexpected injury occurred; that is, that the injury was "by accident." The court of appeals then looked for and found a causal relationship between the injury and the employment by virtue of Lawrence being "exposed to a greater risk than those not working a late night shift, or those working in a different location or job."<sup>68</sup> The court of appeals also found the injury to be in the course of the employment, noting that Lawrence's delay in leaving the premises did not remove her from her employee status.<sup>69</sup> Thus, the Indiana Worker's Compensation Board was held to have the exclusive jurisdiction to determine Lawrence's claim against her employer.<sup>70</sup>

When faced with Lawrence's claim, the Worker's Compensation Board won't have much to decide inasmuch as there has already been a judicial finding between the same parties that an accident arising out of and in the course of the employment has occurred. In effect, the requirement of *Yankeetown* that the three tests be met for jurisdictional purposes results in the usurpation of the function of the Worker's Compensation Board in determining claims and compensability. This is unfortunate because the Worker's Compensation Board has the expertise as well as the statutory mandate to determine employee injury claims. Further, because trial court determination of the underlying claim is required as part of the three-part jurisdictional inquiry, the parties are subject to the expense of presenting the entire claim rather than the presentation of limited facts sufficient to satisfy a simple jurisdictional inquiry.

An example of the difficulties of applying a three-part test for jurisdictional purposes is found in *House v. D.P.D., Inc.*<sup>71</sup> House filed an occupational disease claim with the Worker's Compensation Board claiming that his exposure to noise at work damaged his hearing.<sup>72</sup> The

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would have precluded Lawrence from filing a worker's compensation claim against Consolidated. See, e.g., *Riverview Health Care v. Wright*, 524 N.E.2d 23 (Ind. Ct. App. 1988). The practitioner must remember that in the scramble to relieve the employee of the limited worker's compensation remedy, the employee may find himself in a situation where, there being no strict liability and no provable negligence, he receives nothing for his injury. Such a result was, of course, the evil sought to be remedied by the Worker's Compensation Act in the first place.

68. *Consolidated*, 521 N.E.2d at 1329.

69. *Id.* at 1330.

70. *Id.* at 1331. The Worker's Compensation Board's jurisdiction would be dependent upon a claim having been timely filed pursuant to IND. CODE § 22-3-3-3 (1988). It is interesting to note that Margaret Evans failed to file a claim with the Worker's Compensation Board against Yankeetown Dock Corporation within two years of the accident and when she did file her application for benefits, it was dismissed by the Board.

71. 519 N.E.2d 1274 (Ind. Ct. App. 1988).

72. *Id.* at 1275.



occupational disease claim was dismissed by the single hearing judge because there was no showing that House was disabled; a prerequisite to an occupational disease recovery.<sup>73</sup> House then filed a civil action arguing that since his hearing loss was not covered by the Occupational Disease Act, the exclusive remedy provision of Indiana Code section 22-3-7-6 did not apply to bar his civil claim.<sup>74</sup> The employer filed a motion to dismiss arguing that because House was making an employment related claim, the Worker's Compensation Board had the exclusive jurisdiction to hear it. The trial court dismissed House's claim.<sup>75</sup>

The court of appeals affirmed the dismissal and indicated, in accord with the *Yankeetown* decision, that a claim is a worker's compensation claim if it is:

1. a personal injury or death by accident;
2. arising out of employment; and
3. arising in the course of the employment;<sup>76</sup>

and is an Occupational Disease claim if the employee has suffered:

1. an occupational disease and
2. "disablement" or death.<sup>77</sup>

According to the court of appeals, since there was no showing of disablement, the occupational disease claim was properly dismissed. The court of appeals also concluded that the applicability of the Worker's Compensation Act must be assessed before the jurisdictional issue can be resolved. The court found causation and course of employment<sup>78</sup> and held that the Worker's Compensation Board had the exclusive jurisdiction to determine the claim.<sup>79</sup>

The first of the difficulties raised by the *House* decision relates to the court of appeals' recognition of the three-part test mandated by *Yankeetown* and its failure to apply all three tests. It seems clear that the court of appeals was confronted with a claim which was not compensable as an occupational disease and may very well not have been compensable as an accident.<sup>80</sup> The court of appeals apparently felt that

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73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* at 1275-76.

78. *Id.* at 1276. The findings of "arising out of and in the course of" was made inasmuch as the employer conceded those points. *Id.*

79. *Id.*

80. See *Martinez v. Taylor Forge & Pipe Works*, 174 Ind. App. 514, 368 N.E.2d 1176 (1977). The court of appeals in *Martinez* applied the unexpected result theory of an

as a work-related claim, the Worker's Compensation Board should have the exclusive jurisdiction to make that determination. The court of appeals made the correct decision, and chose to defer to the Worker's Compensation Board the determination as to whether the loss of hearing was unexpected and therefore compensable under the circumstances.<sup>81</sup> Technically, according to the *Yankeetown* decision, such inquiry would be required to be undertaken by the court in order to satisfy the first of the three jurisdictional tests.<sup>82</sup>

A second and potentially more disruptive problem which can be inferred from *House* relates to the use of identical tests for jurisdiction and compensability. With a civil case pending, the court of appeals apparently believed that House's claim, being for an employment related personal injury, was proper for Worker's Compensation Board determination. But, if the court of appeals had determined that the hearing loss was not an unexpected injury and therefore not compensable, an application of *Yankeetown* would lead to civil jurisdiction. This is so by virtue of the supreme court's statement that employee actions which do not meet each of the three tests are not excluded by the Worker's Compensation Act and "may be pursued in the courts."<sup>83</sup> In other words, if a claim meets the three-part test, the Worker's Compensation Board has the exclusive jurisdiction and a right to compensation exists; but, if the claim fails to meet any one of the three tests, compensation is denied and civil jurisdiction exists. The error of this proposition is that the Worker's Compensation Board can have the exclusive jurisdiction of a claim but determine that such claim is not compensable. For example, in *House*, the Worker's Compensation Board may very well determine that gradual hearing loss is not an unexpected injury and therefore is not an accident, and deny compensation. However, such denial does

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accident to Martinez's gradual hearing loss and concluded that the hearing loss did not constitute an injury by accident. That result should not change because of the *Yankeetown* decision as the accident standard applied in *Martinez* was the same as proposed in *Yankeetown*.

81. *House*, 519 N.E.2d at 1276. Presumably, the court of appeals felt that the Worker's Compensation Board, as a finder of fact, would be well qualified to determine whether the injury was unexpected.

82. The court of appeals in *House* concluded that the question of whether an injury was "by accident" is resolved by looking to causation, thereby confusing the three tests. Such an approach side-stepped the difficult issue of determining whether gradual hearing loss was an accident after *Yankeetown*. Such an approach is at direct odds with the court of appeals' decision in *Eastham v. Whirlpool Corp.*, 524 N.E.2d 23 (Ind. Ct. App. 1988), where the determination of an accident was held to be completely separate from causation. The confusion may arise from the fact that the tests for jurisdiction and compensability are the same.

83. *Evans v. Yankeetown Dock Corp.*, 491 N.E.2d 969, 973 (Ind. 1986).



not strip the board of its jurisdiction or the employer of the protection afforded it under the Worker's Compensation Act. Similarly, the finding in *Eastham v. Whirlpool Corp.*<sup>84</sup> that Eastham did not have an accident does not mean that Eastham has a civil cause of action for his strained muscles. One can also envision numerous other situations, such as where an employee with a long-standing vascular insufficiency in his lower extremities subsequently develops a skin ulcer on his leg and claims a right to compensation because he must stand at work. If the Worker's Compensation Board rules that the skin ulceration did not arise out of the employment, such ruling should not open the way for a civil action against the employer.

The Supreme Court in *Yankeetown*, by making its test for jurisdiction the same as that for compensability, arguably has opened the door for civil action in every case where compensation is denied because there was either no accident, or the injury did not arise out of or in the course of the employment. There are cases tried every week before the Worker's Compensation Board which result in a determination that one of those three elements for compensability is absent, but such determination does not lead one to conclude, *ipso facto*, that a civil court has jurisdiction.

#### *B. Jurisdiction and Exclusive Remedy as to Co-employees*

Two recent cases demonstrate the exclusive remedy defense and its application to co-employees. In *Sharp v. Bailey*,<sup>85</sup> Bailey was a truck driver who owned his truck and leased it to Jack Grey Transport, Inc. (Transport). Sharp was a truck driver whose rig was owned by Ruben Adams Trucking (Adams) and leased to Transport as well. Bailey was injured in a collision with Sharp and thereafter sued Sharp, Adams and Transport.<sup>86</sup> The trial court granted summary judgment in favor of Sharp and Adams but denied it as to Transport. The court of appeals found that Bailey was an employee of Transport because of the control which Transport had over him by virtue of the rules and regulations of the Interstate Commerce Commission. Thus, Bailey's exclusive remedy as to Transport was the Indiana Worker's Compensation Act.<sup>87</sup>

The court of appeals affirmed the action of the trial court as to Sharp, holding that because he too was an employee of Transport, he and Bailey were co-employees.<sup>88</sup> The court went on to hold that the

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84. 524 N.E.2d 23 (Ind. Ct. App. 1988).

85. 521 N.E.2d 368 (Ind. Ct. App. 1988).

86. *Id.* at 369.

87. *Id.* at 370.

88. *Id.* IND. CODE §§ 22-3-2-6 and 22-3-2-13 (1988) when construed together prohibit a suit against a fellow employee.

action against Adams must also fail. Because Sharp could not be liable to Bailey, Adams, as a co-employer of Sharp, could not be responsible to Bailey for Sharp's acts under a *respondeat superior* theory of liability.<sup>89</sup>

In *Rogers v. Hembd*,<sup>90</sup> Rogers was an architect and a vice president/employee of Darryl's Restaurant. Hembd was employed by Darryl's Restaurant as a waitress. She was injured when she descended a flight of stairs to a landing and was struck by a door being opened onto the landing. Rogers had designed the restaurant, including the stairs, landing and door arrangement in question.<sup>91</sup>

In reversing a judgment in favor of Hembd, the court of appeals found that the Worker's Compensation Act was Hembd's exclusive remedy.<sup>92</sup> Hembd argued that as an architect, Rogers was subject to suit as a third party because of his professional status. The court of appeals drew a distinction between Rogers' actions as an architect which were subject to the control of Darryl's Restaurant and the actions of a company physician who, by virtue of his profession, exercised judgment independent of his employer,<sup>93</sup> and found Rogers was an employee of the restaurant and, therefore, a co-employee of Hembd's. Hembd also argued that she was entitled to sue Rogers because of his dual capacity as both an employee and an officer of the corporation. That argument was likewise rejected.<sup>94</sup> Based upon these two cases, it can be safely stated that the revisions of the Worker's Compensation Act and the ramifications of *Yankeetown* have not disturbed the availability of the exclusive remedy defense to co-employee defendants in civil actions.

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89. 521 N.E.2d at 370.

90. 518 N.E.2d 1120 (Ind. Ct. App. 1988).

91. *Id.* at 1121.

92. *Id.* at 1124.

93. *Id.* at 1122-23. See *Ross v. Shubert*, 180 Ind. App. 402, 407-08, 388 N.E.2d 623, 627-28 (1979) (company physicians were not immune from suit by virtue of the fellow servant rule).

94. 518 N.E.2d at 1122-23. The dual capacity argument was rejected based on *Witherspoon v. Salm*, 251 Ind. 575, 243 N.E.2d 876 (1969); *Jackson v. Gibson*, 409 N.E.2d 1326 (Ind. Ct. App. 1980); and *Needham v. Fred's Frozen Foods, Inc.*, 171 Ind. App. 671, 359 N.E.2d 544 (1977).



*Appendix I*

## INDIANA WORKER'S COMPENSATION ACT

## Summary of Changes

*Senate Enrolled Act 402.* (Changes effective July 1, 1988, except as indicated)

Benefit increases for temporary total disability equal approximately 55% over the next three years as follows:

After July 1, 1988, maximum average weekly wage equals \$384.00; maximum temporary total disability benefit equals \$256.00. Maximum death benefit equals \$128,000.

After July 1, 1989, maximum average weekly wage equals \$411.00; maximum temporary total disability benefit equals \$274.00. Maximum death benefit equals \$137,000.

After July 1, 1990, maximum average weekly wage equals \$441.00; maximum temporary total disability benefit equals \$294.00. Maximum death benefit equals \$147,000.

I.C. 22-3-3-22

I.C. 22-3-7-19

Benefit increases for permanent partial impairment equal approximately 60% over the next three years as follows:

After July 1, 1988, maximum average weekly wage equals \$166.00; maximum permanent partial impairment benefit equals \$99.60.

After July 1, 1989, maximum average weekly wage equals \$183.00; maximum permanent partial impairment benefit equals \$109.80.

After July 1, 1990, maximum average weekly wage equals \$200.00; maximum permanent partial impairment benefit equals \$120.00.

I.C. 22-3-3-10

I.C. 22-3-7-16

The credit against permanent partial impairment benefits for temporary total disability benefits paid in excess of 52 weeks has been changed so that the credit applies only after the payment of temporary total disability benefits for more than 78 weeks.

I.C. 22-3-3-10

I.C. 22-2-7-16

Funeral benefits will increase from \$2,000 to \$4,000.

I.C. 22-3-3-21

I.C. 22-3-7-15

Disability benefits will be subject to child support withholding.

I.C. 22-3-2-17

I.C. 22-3-7-29

All parties and attorneys will receive notices of hearings and of continuances.

I.C. 22-3-4-5

Real estate professionals, as defined by the statute, are exempted from the Worker's Compensation Act.

I.C. 22-3-6-1

I.C. 22-3-7-9

Artificial limbs and prosthetic devices must be replaced when "medically required." The term "medically required" does not include normal wear and tear.

I.C. 22-3-3-4

I.C. 22-3-7-17

Employees or dependents must be notified of the consequences of a refusal to accept tendered medical services, undergo medical examination, accept tendered employment or allow an autopsy.

I.C. 22-3-3-4

I.C. 22-3-3-6

I.C. 22-3-3-11

An insurer cannot refuse to pay the medical charges of a medical provider approved by the employer.

I.C. 22-3-6-1

I.C. 22-3-7-9

The current 20 year period between exposure to asbestos and disability has been increased to 35 years. The period for filing claims with the Residual Asbestos Injury Fund has been reopened to July 1, 1990. Upon the death of an individual receiving benefits from the Residual Asbestos Injury Fund, a dependent may receive the greater of the remaining 52 weeks of benefits or \$4,000.

I.C. 22-3-7-9

Dependents of the recipients of residual asbestos fund benefits who die before exhausting the remainder of their benefit receive the balance of the 52 week benefit or \$4,000 whichever is greater.

I.C. 22-3-11-3

*House Enrolled Act 1069.* (Changes effective July 1, 1988, except as indicated) The term "Workmen's Compensation" has been changed to "Worker's Compensation" throughout the Act.

The new name for the "Industrial Board of Indiana" will be the "Worker's Compensation Board of Indiana."

I.C. 22-3-1-1

The Worker's Compensation Board may set hearings in the county where the injury occurred or any adjoining county. (Effective March 5, 1988)

I.C. 22-3-4-5

Medical reports may be presented by either party in lieu of live testimony or deposition. The report must be exchanged 30 days prior to the hearing and contain the following information:



I.C. 22-3-3-6

I.C. 22-3-7-18

- (1) The history of the injury, or claimed injury, as given by the patient.
- (2) The diagnosis of the physician or surgeon concerning the patient's physical or mental condition.
- (3) The opinion of the physician or surgeon concerning the causal relationship, if any, between the injury and the patient's physical or mental condition, including the physician's or surgeon's reasons for the opinion.
- (4) The opinion of the physician or surgeon concerning whether the injury or claimed injury resulted in a disability or impairment and, if so, the opinion of the physician or surgeon concerning the extent of the disability or impairment and the reasons for the opinion.
- (5) The original signature of the physician or surgeon. The worker's compensation board shall admit into evidence a statement that meets the requirement of this subsection unless the statement is ruled inadmissible on other grounds.

Any party may object to the report on the basis that it does not meet the requirements of the Act, but the objection must be made 20 days prior to the hearing.



















